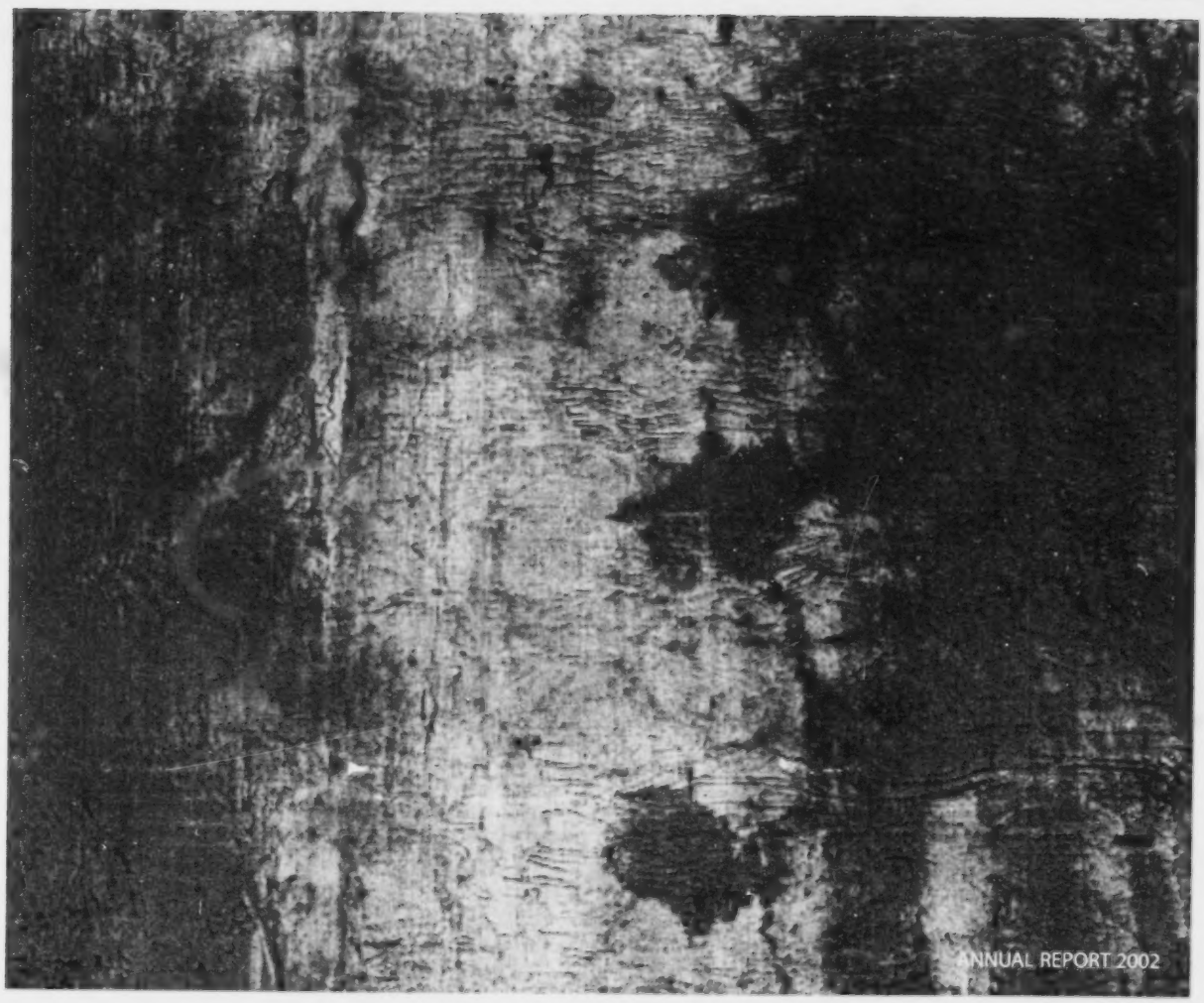
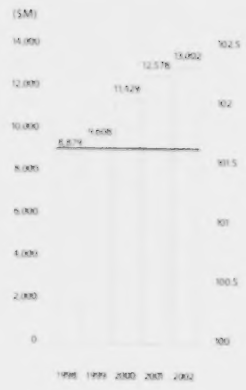
Hydro Québec



($M)	2002	2001 reported	2002 vs 2001 reported (%)	2001 restated*
OPERATIONS AND DIVIDENDS				
Revenue	**13,002**	12,578	3	12,578
Net income	**1,526**	1,108	38	595
Dividends	**763**	554	38	554
BALANCE SHEET				
Total assets	**59,078**	59,861	(1)	58,663
Long-term debt	**36,699**	37,269	(2)	37,269
Shareholder's equity	**14,215**	14,834	(4)	13,539
CASH FLOWS				
Operating activities	**3,812**	3,463	10	3,463
Investing activities	**(2,767)**	(1,924)	44	(1,924)
Financing activities	**(1,003)**	(1,400)	(28)	(1,400)
Cash and cash equivalents at end of year	**293**	251	17	251
RATIOS (%)				
Return on equity	**11.0**	7.6	45	4.4
Average cost of debt	**8.4**	9.0	(7)	10.3
Return on revenue	**11.7**	8.8	33	4.7
Capitalization	**26.2**	26.8	(2)	25.0
Self-financing	**71.6**	54.6	31	54.6

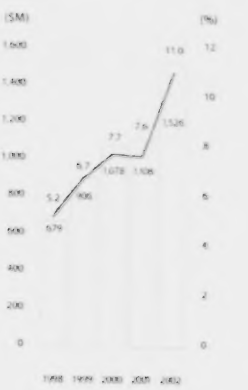
* *Financial data have been restated as a result of the retroactive application of the new foreign currency translation accounting standard (see note 2 to the consolidated financial statements).*

Sales and Average Rate Increase Index



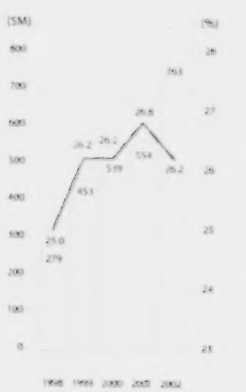
Sales
Average rate increase index (1997 = 100)

Net Income and Return on Equity



Reported net income
Reported return on equity

Dividends Paid and Capitalization



Dividends paid
Reported capitalization

Sales reached $13 billion in 2002, up 3.4% from 2001. The higher volume of transactions on markets outside Québec and increased demand for electricity in Québec explain this growth.

Net income totaled $1,526 million, exceeding the target of $1,060 million set in the *Strategic Plan 2002 - 2006*. Return on equity stood at 11.0% this year, compared with 7.6% in 2001, exceeding the average cost of debt, which was 8.4% in 2002. The improved profitability resulted in increased cash flows from operations, which were used to finance the investment program and pay down a portion of the debt.

Declared dividends total $763 million. They will constitute the sixth consecutive payment to our shareholder and will bring the total amount paid since 1997 to $2.9 billion.

Contents

Message from the Chairman of the Board and the President and Chief Executive Officer

Review of Operations

Hydro-Québec Distribution

Hydro-Québec TransÉnergie

Hydro-Québec Production

Hydro-Québec Equipment

Société d'énergie de la Baie James

Hydro-Québec International

Research and Strategic Planning

Human Resources and Shared Services

Environment

Community Involvement

International Trade

Financial Review

Management's Discussion and Analysis

Consolidated Financial Statements

Supplementary Information

Corporate Administration

Corporate Management

Board of Directors

Corporate Governance

Language Guidelines

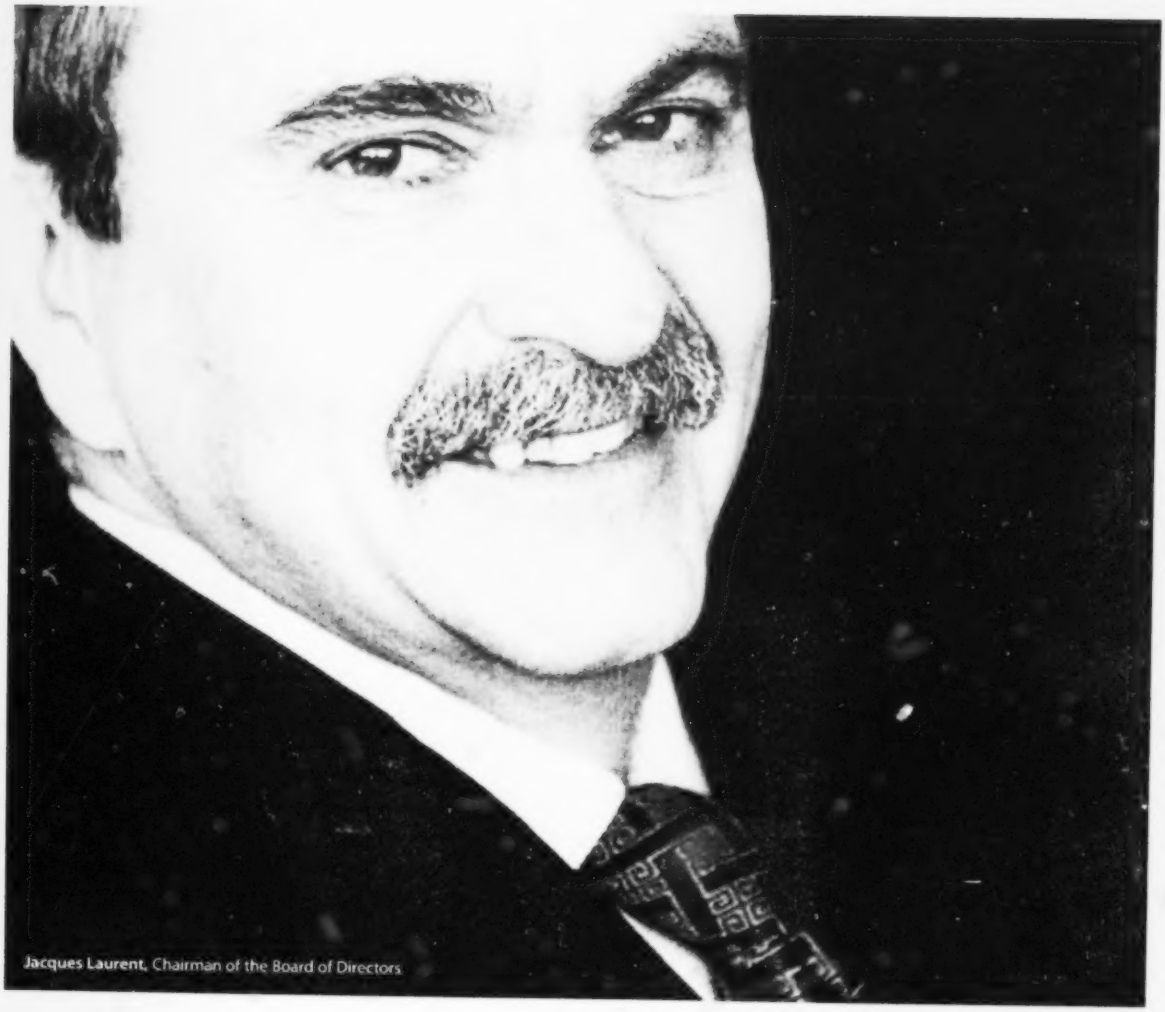
Report of Activities of the Board of Directors and Board Committees

Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec

Generating Facilities

Major Facilities

104-02213/



Jacques Laurent, Chairman of the Board of Directors

Andre Collin, Presid
Executive Officer

Consolidated Growth

Hydro-Québec continued to grow in 2002. Consolidated net income rose to $1.5 billion, an increase of $418 million over the reported net income for 2001, which totaled $1.1 billion. Further to the retroactive restatement required by the new accounting standard for foreign currency translation, net income at December 31, 2002, is up by $931 million compared with last year's restated results.

As in the last two years, the growth in net income stems largely from Hydro-Québec's transactions on external markets and from careful management of our financial expenses at a time when interest rates are low. Electricity demand in Québec has also risen, especially among industrial customers, and in particular in the pulp and paper industry.

Hydro-Québec is maintaining its efforts to boost the return on equity, which amounted to 11.0% in 2002. Improving profitability enables the company to reduce its debt while self-financing its investment activities. It also strengthens the company's contribution to Québec as a whole, by increasing the dividends paid to its shareholder, the Québec government. For the first time in Hydro-Québec's history, the return on equity exceeds the average cost of debt.

Optimizing Hydroelectric Potential

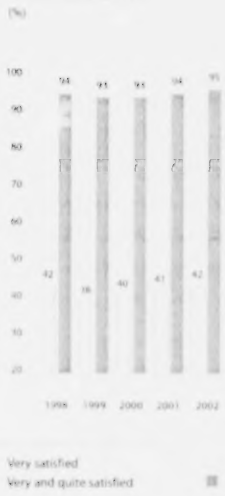
A further highlight of 2002 was the start of construction on major projects intended to increase generating capacity, following productive consultations with the communities concerned. The refurbishing of generating stations and construction of new hydropower facilities that are planned or already under way will add some 2,800 MW to Hydro-Québec's generating fleet in the next decade, at a cost of about $7.2 billion.

Increased generating capacity will enable Hydro-Québec Production to respond to the Distributor's calls for tenders and take advantage of business opportunities on neighboring markets. Since electricity demand is expected to rise an average of 1.5% a year in Québec until 2011, Hydro-Québec Production is continuing to seek new sites for profitable generating facilities.

Following the signing of the Nadoshtin and Boumhounan agreements by Hydro-Québec, Société d'énergie de la Baie James and the Cree Nation, Hydro-Québec began construction of the Eastmain-1 development and is continuing draft design studies for Eastmain-1-A generating station and the partial diversion of the Rupert River to the Eastmain River and Robert-Bourassa reservoir.

Under a partnering agreement with Makivik Corporation, Kativik Regional Government and the Québec government, Hydro-Québec also initiated technical, economic and environmental studies to evaluate the hydroelectric potential of Nunavik, the area of Québec north of the 55th parallel.

To carry out all its construction projects under the best possible conditions, Hydro-Québec relies on Hydro-Québec Équipement and Société d'énergie de la Baie James, whose expertise and know-how are already well established.



In order to meet increasing demand in Québec, Hydro-Québec Distribution issued its first public call for tenders for the purchase of 1,200 MW of firm capacity to be delivered starting in 2007, with the possibility of moving deliveries forward to 2006. The Electricity Supply Plan addresses domestic needs beyond the heritage pool of 165 TWh which Hydro-Québec Production is required to supply to the Distributor. This plan also considers savings stemming from energy efficiency, forecast economic growth in Québec, changes in weather conditions and other factors likely to affect electricity demand.

Hydro-Québec maintained its initiatives in energy efficiency, an area in which it remains a leader. In the last decade, the many programs it has promoted have generated energy savings of 2.5 TWh. The company has also played a major role in changes in standards, technical regulations and consumer habits, all of which should lead to natural savings. Hydro-Québec Distribution filed a comprehensive Energy Efficiency Plan with the Régie de l'énergie (energy board), developed after consultation with various stakeholders, to expand on the progress already made in terms of energy efficiency in space and water heating, lighting and industrial processes. The Plan comprises 16 programs intended for the different categories of customers, and aims to achieve new energy savings totaling 750 GWh by 2006. Hydro-Québec also has many R&D projects designed to develop processes for improving the energy performance of its generating, transmission and distribution operations.

Hydro-Québec TransÉnergie continued to improve the transmission system in order to maintain its reliability. In addition, the division received Québec government authorization to resume construction of the Hertel–Des Cantons line and to build the Montérégie substation, thus completing the 735-kV loop in this region.

To sustain growth, Hydro-Québec continued to develop its commercial activities. It conducts profitable purchase/resale transactions on neighboring markets, where it also exports surplus energy. Since wholesale markets were opened up, the company's sales outside Québec have increased more than fivefold, from $0.6 billion in 1997 to over $3.5 billion in 2002.

Hydro-Québec continued its activities on the international scene. In 2002, it completed and commissioned a 180-km, 220-MW interconnector linking the states of Victoria and South Australia. It also completed construction of the high-voltage underwater line linking southwestern Connecticut and Long Island, N.Y. (Cross Sound Cable project).

Also in 2002, Hydro-Québec launched an oil and gas exploration program for the estuary and Gulf of St. Lawrence and the Gaspé Peninsula. This program will be carried out over the next eight years, in cooperation with private partners in the oil and gas industry that have both the expertise and the financial capacity required. The geoscientific studies that industry specialists have already completed in the region point to the existence of extensive hydrocarbon reserves that can be developed at a favorable cost. The company plans to act as a catalyst for this project by investing approximately $330 million by 2010—about 20% of the total cost of the exploration work. Confirmation of this territory's potential could yield substantial economic spinoffs, both for Hydro-Québec and for Québec as a whole.

Finally, Hydro-Québec stayed firmly committed to research and development. It is one of the 20-odd Canadian companies that invest $100 million or more per year in R&D, and it intends to remain a leader in the field.

In 1999, Hydro-Québec decided to refocus its R&D efforts on core businesses—electricity generation, transmission and distribution—in order to improve its processes and make the power supply more reliable. It gave priority to projects offering the greatest potential for creating value, be it in additional sales, costs avoided, productivity gains or extended useful life for facilities. Technological innovation enables Hydro-Québec's divisions to enhance their competitive edge. The company also maintains ongoing intelligence-gathering to determine which developing technologies are likely to have an impact on its own operations.

Research efforts have led to the establishment of two business ventures in which Hydro-Québec has a substantial stake. In 2002, AVESTOR, a joint venture of Hydro-Québec and Kerr-McGee Chemical, opened a plant that manufactures the lithium-metal-polymer (LMP) battery, a product whose applications and environmental benefits should prove significant, particularly in the telecommunications and automotive industries. At the same time, HERA Hydrogen Storage Systems, jointly owned by Shell Hydrogen, Gesellschaft für Elektrometallurgie (GfE) and Hydro-Québec CapiTech, stepped up its program to develop ways of using metal hydrides to store hydrogen. Hydro-Québec is also working to commercialize AVESTOR's ambient-temperature LMP battery and certain components of the TM4 motor-wheel technology, with a view to incorporating them into an electric vehicle.

Contributing to Sustainable Development

The will to preserve the environment underlies all of Hydro-Québec's business decisions, and the company puts the knowledge acquired in this area to maximum use in developing its generation and transmission construction projects. As well, the *Summary of Knowledge Acquired in Northern Environments from 1970 to 2000* presents the results of the numerous measures the company has implemented to limit the impact of its activities in northern Québec, along with the forecasting models it developed and validated over that period. With the extensive databases it has established in the course of its past projects, Hydro-Québec is now able to precisely identify the impacts of any new development project in the region. It aims not only to preserve but to enhance the biophysical environment in areas where new facilities are built.

Over these 30 years of studies, Hydro-Québec showed that development can and must go hand in hand with environmental preservation and enhancement. In addition to this undertaking, it has made an even more fundamental commitment to develop Québec's hydropower potential with the support of local communities by closely involving them in the operation of its facilities and the resulting economic spinoffs.

Working Together to Fulfill Our Social Commitments

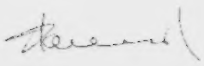
Looking back on a year filled with projects and accomplishments, we wish to express our gratitude to the members of the Board of Directors for their contribution to Hydro-Québec's growth. We would also like to take this opportunity to welcome Andrée Corriveau, who joined the Board during the year. The directors' professionalism and expertise play a large part in the achievement of our objectives. In addition, the importance Hydro-Québec attaches to sound corporate governance practices and to the *Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec* (see page 110) ensures transparency in a company whose goals are in perfect harmony with its mission.

We also thank our senior managers, who contribute both vision and determination to Hydro-Québec's development and vitality. Their commitment is the cornerstone of our growth.

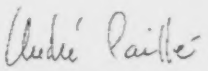
Our appreciation goes as well to our employees, who have shown a renewed sense of loyalty and belonging. Their job satisfaction is a major element in the success of a company that plays an essential role in Québec society.

To replace employees who will be retiring in the coming years, we have continued to identify members of our workforce who can ensure succession in key positions. We are also counting on the knowledge and enthusiasm of new employees, and young recruits in particular. The Institute of Electrical Power Engineering, founded by Hydro-Québec in cooperation with six Québec universities, began training specialized engineers last fall. We must see to it that these future graduates, as well as all our future employees, have the opportunity to inherit the body of knowledge developed by their seniors, who have made our company a world leader in the design, construction and operation of large-scale generating and transmission facilities.

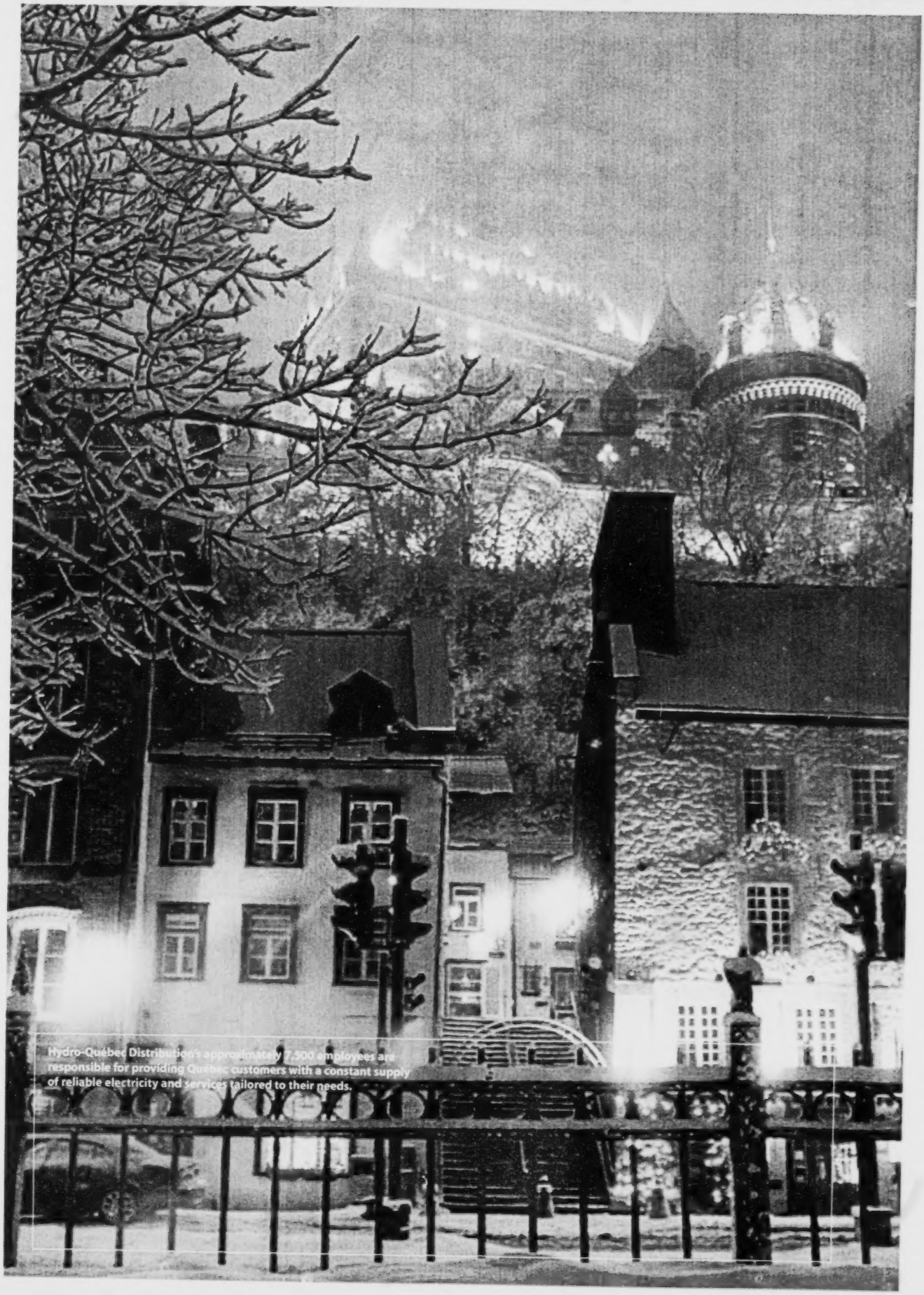
Hydro-Québec holds a prime position among the world's major generators and suppliers of electricity, thanks to the determination, courage and unfailing confidence in the future demonstrated by its builders. We firmly believe that the quality and competence of the people who take over from them will allow us to continue to advance and successfully meet the tough yet stimulating challenges posed by our industry.



Jacques Laurent
Chairman of the Board of Directors



André Caillé
President and Chief Executive Officer



Hydro-Québec Distribution's approximately 7,500 employees are responsible for providing Québec customers with a constant supply of reliable electricity and services tailored to their needs.

HEAT, LIGHT, COMFORT, EFFICIENCY—THROUGH THE ELECTRICITY IT SUPPLIES TO ITS QUÉBEC CUSTOMERS, HYDRO-QUÉBEC DISTRIBUTION PLAYS A KEY ROLE IN MAINTAINING THEIR QUALITY OF LIFE, BOTH WINTER AND SUMMER.

2.8

million customers, or 3.6 million accounts.

OUR BUSINESS
Distributing Power

Hydro-Québec Distribution is responsible for supplying Québec markets with electricity. It ensures the reliability of its distribution system and security of supply to the approximately 2.8 million customers it serves.

To fulfill its mission, the division operates a system of 106,830 km of distribution lines, 9% of it underground. It also runs 24 thermal power plants with a total installed capacity of 121 MW that supply power to off-grid systems in some municipalities along the North Shore, on the Magdalen Islands and in northern Québec. Hydro-Québec Distribution has assets worth a total of $9.8 billion. In 2002, sales amounted to 158.3 TWh, generating $8.1 billion in revenue.

To meet the annual growth in sales, which is expected to average 1.5% from 2001 to 2011, Hydro-Québec Distribution must reach agreements with power producers giving it access to new sources of supply.

In 2002, in accordance with the Electricity Supply Plan approved by the Régie de l'énergie (energy board), Hydro-Québec Distribution issued a call for tenders with a view to signing long-term contracts for the supply of 1,200 MW of electricity.

Hydro-Québec Distribution also filed its Energy Efficiency Plan with the Régie, targeting overall energy savings of 750 GWh by 2006. The plan will be the subject of hearings in the first few months of 2003. Another application dealing with the Distributor's cost of service was submitted to the Régie as the first step in the rate-setting process.

In addition, Hydro-Québec Distribution undertook to continue its efforts to improve service quality by adapting its supply to meet customer expectations. And indeed, the overall customer satisfaction index rose from 7.33 out of 10 in 2001 to 7.40 in 2002.

At a time of significant fluctuations in fuel prices, the heritage pool gives Québec customers access to stable rates that are among the lowest in North America.

Electricity's share in Québec's energy mix has held steady at about 41% since the early 1990s.

"Provide reliable and continuous electricity service to Québec customers. Ensure a secure supply of electricity. Offer services adapted to customers' priority expectations."
Strategic Plan 2002-2006, page 30

Yves Filion
President
Hydro-Québec Distribution

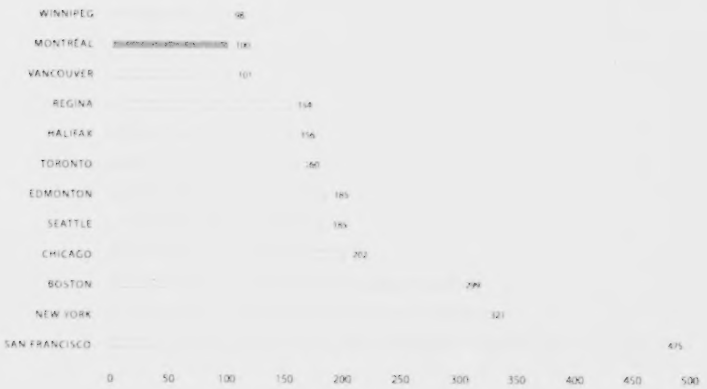
Supply

To meet the demand for electricity in Québec, Hydro-Québec Distribution has access to an annual supply of 165 TWh through the heritage pool which Hydro-Québec Production is required to make available.

Filling needs beyond the heritage pool requires an Electricity Supply Plan that must be approved by the Régie de l'énergie. Calls for tenders must be issued for these additional supplies, following a procedure and a code of ethics approved by the Régie.

Hydro-Québec Distribution's Electricity Supply Plan was approved by the Régie, which considered the demand forecast to be reasonable and approved the supply strategy for both the main system and off-grid systems.
The first call for tenders was issued for the purchase of 1,200 MW of electricity to be delivered in 2007, with the possibility of commencing deliveries in 2006.
The Régie de l'énergie authorized a call for tenders for 400 MW of dispatchable electricity.*

Comparative Index of Electricity Prices, Residential Customers – May 1, 2007[1]
(Montréal = 100)



1. *Monthly bill (before taxes) for a consumption of 1,000 kWh.*

* *Dispatchable electricity: Electricity whose delivery is scheduled by Hydro-Québec Distribution over long periods, mainly to meet higher-than-expected growth in demand.*

Customer Services

Most customer inquiries arrive at the Hydro*Direct* call centre, which has the personnel and advanced technology needed to handle more than five million calls a year. Business customers in each of the five territories have access to commercial representatives who are able to advise them on their energy options.

Residential Customers

Sales volume in the residential and farm category rose from 51 TWh in 2001 to 53 TWh in 2002, and revenue increased from $3.1 billion to $3.2 billion.

The residential customer satisfaction index improved, from 7.39 out of 10 in 2001 to 7.42 in 2002.

In cooperation with community organizations and the Québec government, efforts continued to find lasting, equitable solutions for the most economically disadvantaged customers.

An agreement was signed with *epost* allowing Hydro-Québec customers to use this service to receive, pay and manage their electricity bills online. This service is already offered by several dozen Canadian companies.

The website was improved and now offers customers access to the information they need for better consumption management.

Business and Commercial Customers

Sales volume grew from 38 TWh in 2001 to 39 TWh in 2002, while revenue increased from $2.5 billion to $2.6 billion.

Between 2001 and 2002, the satisfaction index rose considerably, from 7.40 out of 10 to 7.53 for commercial customers, and from 7.13 to 7.28 for business customers.

Service Quality	**2002**	2001	Change
Rate of new hookups on schedule	**93%**	93%	–
Rate of meter reading	**96%**	96%	–
Rate of call response in under 20 seconds			
– Residential customers	**69%**	66%	↑ 3%
– Business and commercial customers	**72%**	69%	↑ 3%
Average hours of distribution service interruption per customer – gross	**3.30**	3.82	↓ 0.52
Average hours of distribution service interruption per customer – adjusted*	**2.05**	2.11	↓ 0.06

** Not including exceptional weather events.*

More than 3,700 networked meters were installed at business customers' premises, allowing these customers to obtain information on their consumption profile, group multiple accounts on a single bill and choose their own billing date.

The business customer satisfaction index concerning notification of scheduled outages and negotiation of related arrangements rose from 7.1 in 2001 to 7.5 in 2002.

The satisfaction index for information received in the event of power failures also improved appreciably for business customers, from 6.6 in 2001 to 7.1 in 2002.

The handling of calls from business customers was decentralized to the Laurentides, Montmorency, Montréal and Richelieu territories in order to establish closer customer relations and develop greater synergy with the units in charge of sales and after-sales service.

LTE, Hydro-Québec's energy technology laboratory, carried out 18 projects. The laboratory offers business customers expertise and high-quality services in all fields related to energy use and management.

The Visilec project was submitted to the Régie de l'énergie. This paid Web-based service is designed to let business customers track their consumption and control their costs better.

Large-Power Customers

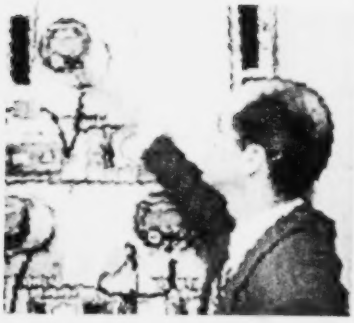
Consumption by large-power customers (industrial, commercial and institutional organizations requiring more than 5 MW of power) was up during the year. Sales to this customer category, which consumes 42% of all electricity delivered in Québec, rose from 64 TWh in 2001 to 66 TWh in 2002, and revenue increased from $2.2 billion to $2.3 billion.

Large-power customer satisfaction improved once again, as it has every year since 1997, reaching 8.9 in 2002, compared with 8.7 in 2001.

New electronic meters were installed at the premises of more than 80% of our large-power customers. These meters provide access to detailed information on hourly electricity consumption.

Rates competitive with those of other North American power systems were maintained. According to a survey of 21 electric utilities, Hydro-Québec's Rate L, which applies to customers that require 50 MW of power (at 120 kV and a load factor of 85%), ranks as the fourth-lowest rate in North America. The stability of this rate is a definite advantage considering the volatility of energy prices throughout the continent.

The commitment made to large-power customers in 2001 to maintain a business partnership based on quality and satisfaction was continued. This commitment takes various forms: a high level of availability through one-stop access for handling requests, an attentive, personalized business approach, high-quality power and real-time communications (via the Internet).



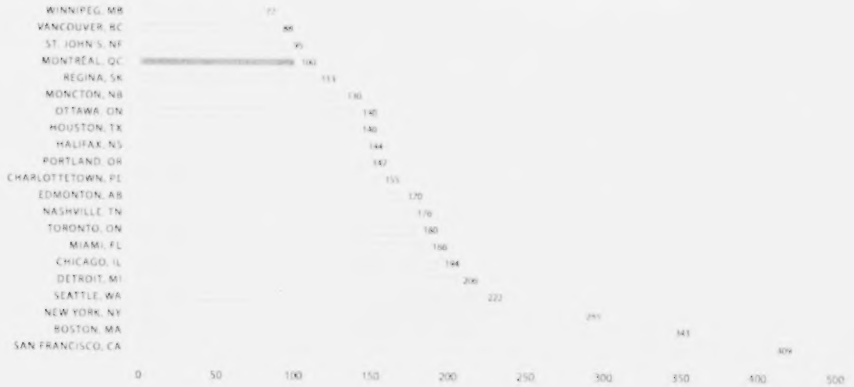
The company held 203 quality partnership sessions to examine various aspects of customer satisfaction.
A cooperative agreement was signed with the COREM consortium concerning a major research program to improve mineral-grinding processes and increase productivity in the Québec mining industry.

Electricity Service

Projects to strengthen the system in areas with a high ice risk continued.
Reinforcement work has now been carried out on approximately 3,300 km of lines.
Pruning operations were performed to improve security of supply. In 2002, vegetation caused one-third of all outages on the system.
The rate of new hookups on schedule held steady at 93%, despite a sharp increase in the number of new customers.
The division contributed $17 million under the government program for undergrounding distribution systems. This funding went to 14 new projects for burying grids in heritage, cultural and tourist sites.
Expertise and Technical Support obtained ISO 9001:2000 certification.
The recommendations of the liaison committee for Hydro-Québec and the Québec federation of municipalities were implemented with a view to improving communications between the company and municipalities in emergencies.
A memorandum of understanding on vegetation control, reached by Hydro-Québec Distribution, the Québec federation of municipalities and the union of Québec municipalities, was put into effect.

Large Power Customer Satisfaction

Comparative Index of North American Electricity Prices, Large Power Customers, May 1, 2002 (Montréal = 100)



1 *Index for 50 MW of power at 120 kV and a load factor of 85%.*

Technological Innovation

At its energy technology laboratory LTE, the institute also develops various means of increasing energy efficiency based on the needs of Hydro-Québec customers. LTE's areas of expertise, which originally concentrated on electrotechnologies and electrochemistry, have gradually expanded to include energy management, energy efficiency and power electronics.

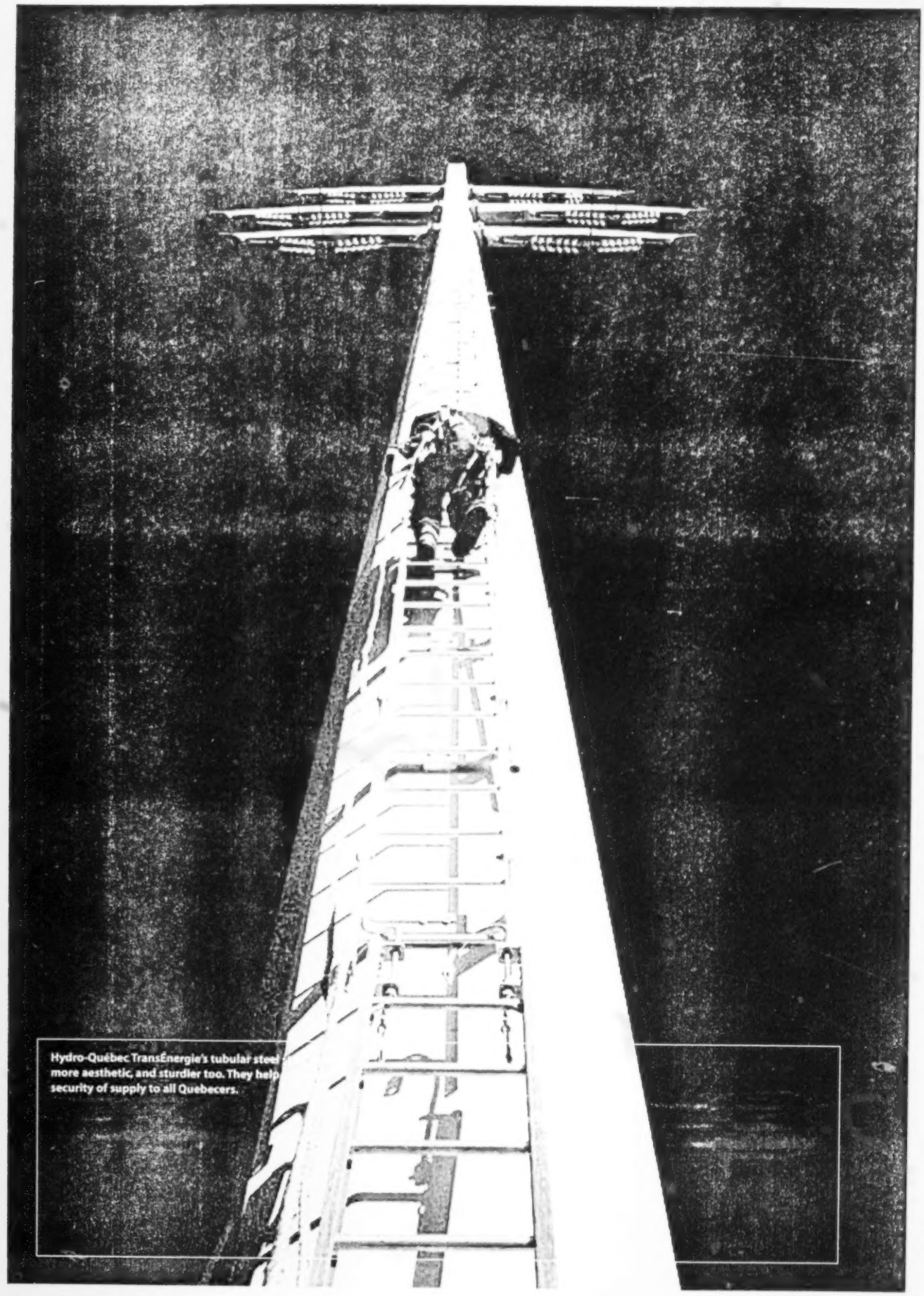
The solid-insulation transformer developed by the Québec energy transmission innovation centre (CITEQ), which will enable us to offer new undergrounding options, was certified.
Poles treated with a polymer additive extending their service life came into use; this treatment was developed to solve the problem of hardening and make line workers' jobs easier.

Information Technologies

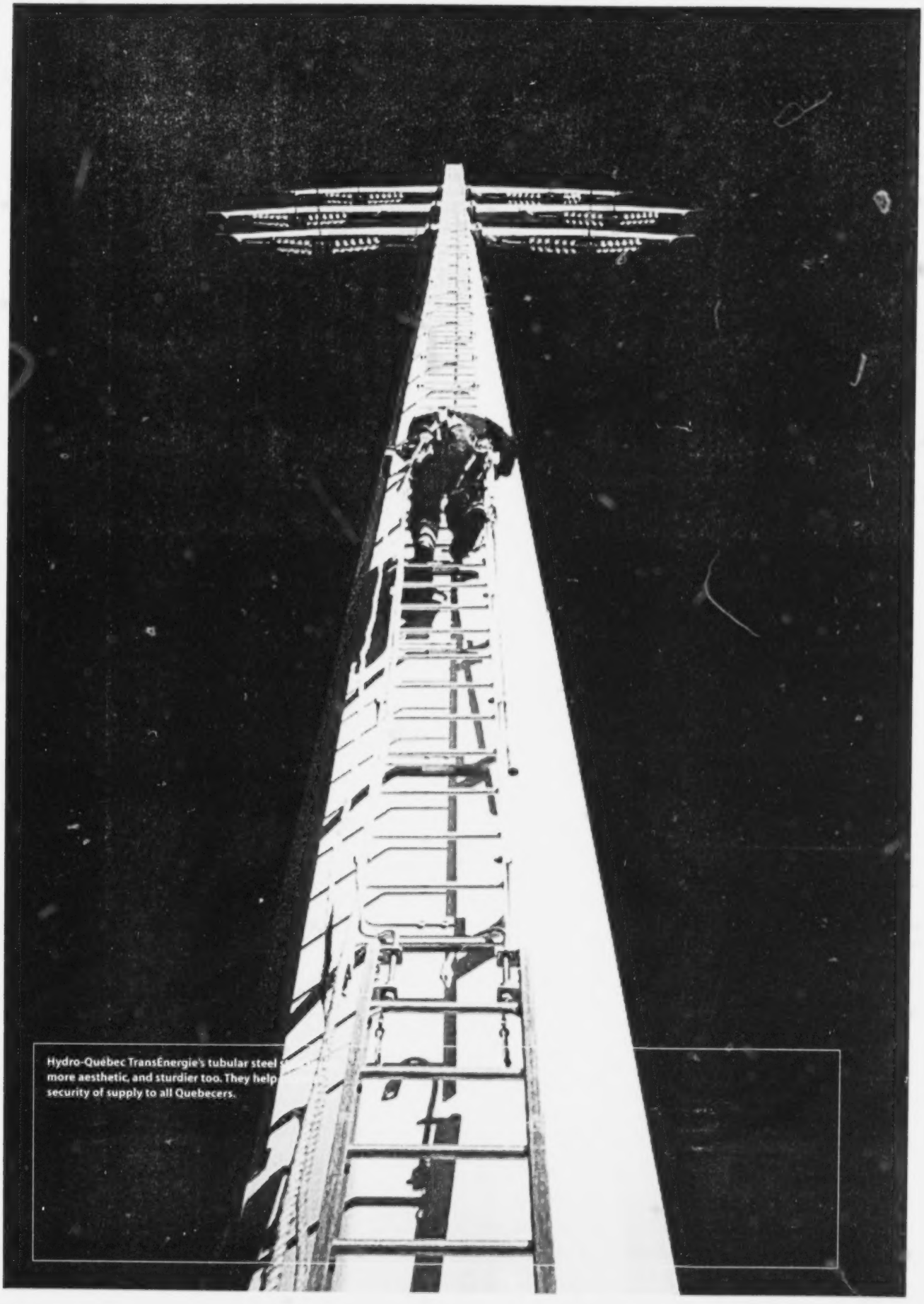
The Régie de l'énergie approved the project to modernize customer information systems, thereby improving service quality in order to meet current and future customer needs. Since this project entails a review of business processes, it will improve the division's efficiency.
The area to be covered by the geographic information system was determined, in preparation for implementation in 2004. This information system incorporates all data, maps and analytic tools required for optimum planning of operations performed on the system into a single geographically referenced base.
The number of customers receiving or paying their electricity bills online more than doubled, from 25,500 in 2001 to 53,500 in 2002.
The amount of information on the Hydro-Québec website was also increased and the range of possible transactions expanded. The site recorded more than two million hits in 2002.
The division began implementing Maximo, a program to modernize its equipment maintenance management for off-grid systems.

Expertise and Human Resources

The program for trade employee empowerment was applied. This program affects 1,800 employees at Hydro-Québec Distribution.
Some 1,118 site inspections were carried out as part of a safety audit program designed to verify the application of safety rules.
The work-related accident frequency decreased from 4.96 per 200,000 hours worked in 2001 to 4.39 in 2002.



Hydro-Québec TransÉnergie's tubular steel
more aesthetic, and sturdier too. They help
security of supply to all Quebecers.



Hydro-Québec TransÉnergie's tubular steel
more aesthetic, and sturdier too. They help
security of supply to all Quebecers.

A LEADER IN TRANSMISSION SYSTEM DESIGN, OPERATION AND MAINTENANCE, HYDRO-QUÉBEC TRANSÉNERGIE DOES EVERYTHING POSSIBLE TO ENSURE THE RELIABILITY OF ITS FACILITIES.

34,989 MW

to meet peak demand in Québec in the winter of 2002–2003—a new record.

OUR BUSINESS

Transmitting Power

Hydro-Québec TransÉnergie is a leader in transmission system design, operation and maintenance. The division manages the most extensive transmission system in North America. It supplies high-quality power to its customers throughout Québec. Through its interconnections, it also transmits power to Ontario, the Maritime Provinces and several states in the U.S. Northeast. It assures its customers of a level of reliability that complies with the highest standards of the North American power industry. Simultaneously and without discrimination, it disseminates information on available transmission capacity to all prospective users of its system via the OASIS (Open Access Same-Time Information System) website.

To be able to manage a growing volume of power flows, the division adheres to a strict facility maintenance program. It also pursues research and development in order to increase transmission capacity and ensure system stability. In addition, in an open-market environment in which its system is in growing demand, it works to optimize the use of its interconnections with neighboring systems. This optimization also helps increase the security of Hydro-Québec Distribution's sources of supply.

Hydro-Québec TransÉnergie is responsible, as well, for managing Hydro-Québec's telecommunications network, of which it is the main user.

Worldwide, the leading-edge expertise developed by Hydro-Québec TransÉnergie is increasingly sought after, in planning and live-line work as well as in system operation and simulation. The division continues to consolidate its international customer base through the acquisition of transmission assets and the construction and operation of transmission lines, especially in the United States and South America.

In carrying out its activities, Hydro-Québec TransÉnergie always respects the environment and adopts the best practices for harmoniously integrating its facilities into their surroundings.

At year-end, the Hydro-Québec TransÉnergie system comprised 32,314 km of lines, 505 substations and 15 interconnections with neighboring systems. The division's assets in Québec totaled $18.3 billion.

Jacques Régis
President
Hydro-Québec TransÉnergie

Service Continuity

Its system is accessible and efficient, providing its customers with high-quality service. Since 1990, the hours of transmission service interruption have fallen by an average of six minutes a year.

Hours of service interruption (gross) have been kept below the target of 0.65 hours, with an average of 0.55 hours in 2002. This performance allows Hydro-Québec TransÉnergie to maintain optimum service quality while avoiding overinvesting in the system.
Construction work began on the 735-kV Saint-Césaire–Hertel line and Montérégie substation. This will increase security of supply to Montérégie, part of downtown Montréal and areas west of downtown.
System operating methods were adapted to maximize interchanges with neighboring systems.

System Reliability

Some $270 million was invested to ensure the long-term operability of the transmission system.
A 20-km, 120-kV line was commissioned between Sherbrooke substation, in Saint-Élie-d'Orford, and Magog substation to improve the reliability of the grid in and around Magog.
A vibroacoustic monitoring system was installed to detect failures in equipment used to reduce voltage fluctuations on the system.
Modernization of the System Control Centre was completed.
Cedars Rapids Transmission Co. was authorized by the National Energy Board to build a 71-km, 230-kV line (operated at 120 kV) to replace a line dating from 1915.

Technological Innovation

Together with Hydro-Québec's research institute and other partners, it has developed technologies that are among the most advanced in its field, ranging from line route design to the management of extensive, complex systems.

A program of dynamic testing was carried out to evaluate transmission line behavior in the event of tower, conductor or hardware failure.
A de-icer for use on live lines (conductors or ground wires) was developed.
The Hydro-Québec TransÉnergie chair for power system simulation and control was inaugurated, in collaboration with the École de technologie supérieure. Québec now has a world-class centre of scientific and technological excellence in this field.

Environment

The division has made its concern for the environment an integral part of every stage of facility construction, operation and maintenance. In addition, it has established a strict environmental follow-up program as well as measures for preventing or mitigating the environmental impacts of its activities.

The MurrayLink interconnector, built in Australia by TransÉnergie U.S., won four awards for its environmental quality.

International

The division's international project portfolio includes a number of investments and interests, including the Transelec transmission system in Chile, the TransMantaro transmission line in Peru, and the DirectLink and MurrayLink interconnectors in Australia. All these facilities are already in operation. In 2002, revenue generated by Hydro-Québec TransÉnergie's foreign operations totaled $251 million.

Construction was completed on the 40-km high-voltage underwater line designed to carry 330 MW between southwestern Connecticut and Long Island, N.Y. (Cross Sound Cable project); Hydro-Québec TransÉnergie has a 75% stake in this project.
MurrayLink, a project designed and built by TransÉnergie U.S., was commissioned in Australia. This 220-MW, 180-km interconnector links the states of Victoria and South Australia.

Regulatory

The division must also comply with the requirements of the Northeast Power Coordinating Council (NPCC) and the North American Electric Reliability Council (NERC).

The Régie de l'énergie handed down a decision authorizing Hydro-Québec TransÉnergie to amend transmission rates on its system retroactively to January 1, 2001. The Régie's decision sets the division's return on equity at 9.66%. The energy board considers that Hydro-Québec has demonstrated the operating efficiency of consolidating its transmission operations in the Hydro-Québec TransÉnergie division.
An application for approval of system reliability standards was filed with the Régie.
An application was filed with the Régie for construction of a line linking the planned Toulnustouc generating station with the Hydro-Québec TransÉnergie system.
Hydro-Québec TransÉnergie also filed for approval of its 2003 budget for capital projects with a unit cost of under $25 million.

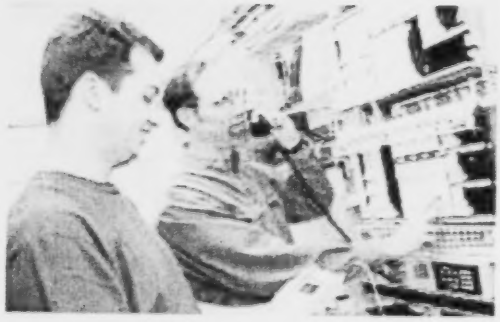
Information Technologies

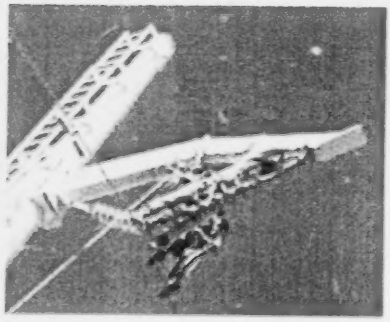
The computer infrastructure at the backup centre, which takes over from the System Control Centre computer system in the event of a failure, was updated.
The telecommunications and transmission maintenance and operating systems were further harmonized.
Implementation was completed on Maximo, a support program for Hydro-Québec TransÉnergie's facility maintenance activities.

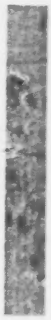
Expertise and Human Resources

To encourage employees to enrich and share their knowledge, the division uses various means such as formulating standards and methods or holding forums.

The TÉ-2002 exhibition was held to showcase employee know-how and present products and services used by the division's personnel. The event, which took place at Montréal's convention centre, attracted some 2,300 visitors.
The frequency of work-related accidents involving lost time and medical assistance decreased to 3.6 per 200,000 hours worked, compared with 4.4 in 2001.
The program for greater trade employee empowerment, which affects some 1,400 employees at Hydro-Québec TransÉnergie, was instituted.
Computer-based tools were developed to provide training on the new *Work Safety Code*, implemented by Hydro-Québec TransÉnergie in 2002.







...ydroelectric generating station,
...e La Tuque facility helps reduce greenhouse
...gas emissions in Québec.

AT A TIME OF MARKET DEREGULATION, HYDRO-QUÉBEC PRODUCTION IS OPTIMIZING THE USE OF ITS FACILITIES AND DEVELOPING QUÉBEC'S HYDROPOWER POTENTIAL.

$7.9

billion in sales.

OUR BUSINESS
Generating
and Wholesaling Power

Hydro-Québec Production generates electricity and sells it on wholesale markets both inside and outside Québec. For the Québec market, the division supplies a heritage pool of up to 165 TWh of electricity per year, which it is obliged to sell at a fixed price of 2.79 cents per kilowatthour. Beyond this volume, it competes freely in response to Hydro-Québec Distribution's calls for tenders.

It conducts various transactions on markets outside Québec. These transactions, mainly short-term electricity sales and purchases, are profitable and help optimize the use of its generating stations and reservoirs.

The division sells the output of generating facilities that are 97% hydroelectric. It runs them under optimum cost and efficiency conditions, and takes the necessary measures to ensure their long-term operability. Its assets total $24.6 billion.

The division maintains a diversified portfolio of projects to increase generating capacity and take advantage of market growth. As well, it secures other sources of supply by such means as long-term contracts with independent power producers in Québec, with the emphasis on renewable energy.

Hydro-Québec Production also makes the most of its expertise on foreign markets, including Central America, China and the United States, through targeted investments and technical services contracts.

"Operate Hydro-Québec's generating facilities ... Develop Québec's hydroelectric potential, sell electricity on wholesale markets inside and outside Québec."
Strategic Plan 2002-2006, page 10

Thierry Vandal
President
Hydro-Québec Production

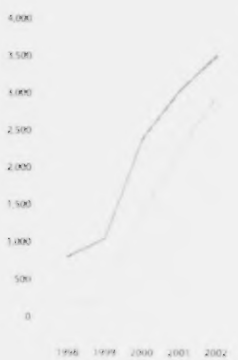
Wholesale Markets

The external markets for electricity, and for energy in general, experienced considerable upheaval in 2002, particularly on a financial level. Despite the difficult circumstances facing the industry, sound management of the company's activities on these markets yielded positive results.

Revenue from sales outside Québec grew 13% in 2002 to $3.5 billion. To effect these sales, Hydro-Québec Production purchased a total of $2.3 billion of electricity on U.S. short-term markets. The division also used 12.6 TWh from its Québec facilities, compared with 10.2 TWh in 2001.

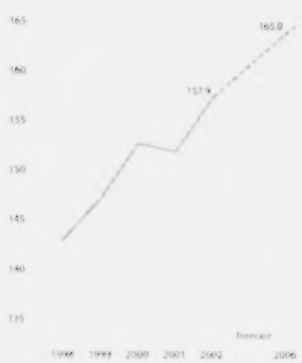
The division sold Hydro-Québec Distribution 158.0 TWh at a fixed price of 2.79 cents per kilowatthour (heritage pool), generating revenue of $4.2 billion.
Through its subsidiary HQ Energy Marketing, it was active on the Ontario power market, which has been open since May 1, 2002.
Hydro-Québec Production was selected to supply 600 MW beginning in 2006–2007, under the call for tenders issued by Hydro-Québec Distribution to meet additional needs on the Québec market.

Sales Outside Québec and Short-Term Purchases
($M)



Sales
Purchases

Electricity Sales to Hydro-Québec Distribution
(TWh)



Operations

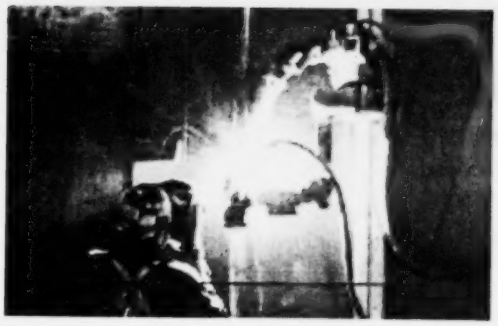
This fleet, which includes 50 hydroelectric and 5 thermal generating stations, has a total installed capacity of 32,516 MW. Added to this is most of the generation from Churchill Falls power plant, in Labrador, which has an installed capacity of 5,428 MW. The hydroelectric developments also include 25 large reservoirs, with a storage capacity of 172 TWh, and 562 dikes and dams. In 2002, Hydro-Québec Production invested $305 million in ensuring the security, reliability, long-term operability and optimum performance of its generating facilities.

Refurbishing of Bersimis-1 generating station continued.
Refurbishing and refitting went on at Outardes-3 generating station. This work will add approximately 260 MW to its installed capacity.
Power station refurbishing and dam rehabilitation continued at Rapides-des-Quinze.
The rehabilitation of Beauharnois generating station continued.
Rehabilitation began on Coteau-1, Coteau-3, Île-Juillet-1 and Île-Juillet-2 dams, upstream from Les Cèdres generating station.
Construction proceeded on two new spillways and dams on the sites of the former Chute-Garneau and Pont-Arnaud generating stations, at the request of the Québec government.
The operating permit for Gentilly-2 nuclear generating station was renewed for four years.
The company continued to study the overhaul of Gentilly-2.

Development Projects

The projects under study or already in progress meet stringent criteria for profitability, favorable reception by local communities and respect for the environment.

Work proceeded on a new $430-million, 220-MW hydroelectric development on the Saint-Maurice River, at Grand-Mère.
Construction also continued on an $800-million, 553-MW hydroelectric generating station on the Toulnustouc River.
Ground was broken on the $2-billion Eastmain-1 development, and draft design began for Eastmain-1-A generating station and the Rupert diversion. Together, these facilities will be able to generate up to 12.6 TWh per year.
Additional work went on at the 882-MW Sainte-Marguerite-3 generating station, with a view to commissioning in 2003.
The Québec and Canadian governments approved the partial diversion of the Manouane River to Pipmuacan reservoir, upstream from Bersimis-1 and Bersimis-2 generating stations.
The Portneuf and Sault aux Cochons rivers were partially diverted to Pipmuacan reservoir.
Draft design work proceeded on the 385-MW Péribonka generating station, on the river of the same name.
In connection with the 800-MW Suroit combined-cycle gas-fired power plant, draft design was completed and hearings were held by the Bureau d'audiences publiques sur l'environnement.



Technological Innovation

MATH (the French acronym for hydraulic turbine analysis models) technology was introduced at La Grande-3 generating station, improving the facility's performance.
Major improvements were made to Scompi the robot, used in the manufacture and repair of hydraulic-turbine runners. The robot demonstrated its many advantages when it was tried at Beauharnois generating station in 2002 and in a project in China run by GE Hydro.
It was also used to perform tunnel lining work at Sainte-Marguerite-3 generating station.
Robotic diagnostic and intervention tools were developed to help reduce maintenance costs at Gentilly-2 generating station.

Environment

ISO 14001 registration was maintained for the environmental management system of the department responsible for generating facility operation.
The division joined with Université Laval in a research project to develop a technology for capturing CO_2, a greenhouse gas.
Research demonstrated that reservoirs 10 years of age or older emit one-half to one-third the amount of greenhouse gas emitted by reservoirs under six years old, and no more than natural lakes.
An action plan to improve the efficiency of facility wastewater treatment systems was implemented.

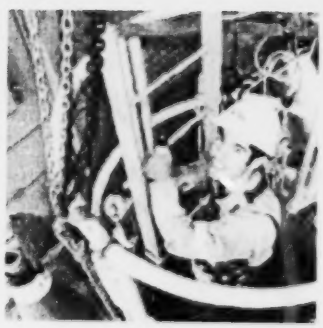
International Activities

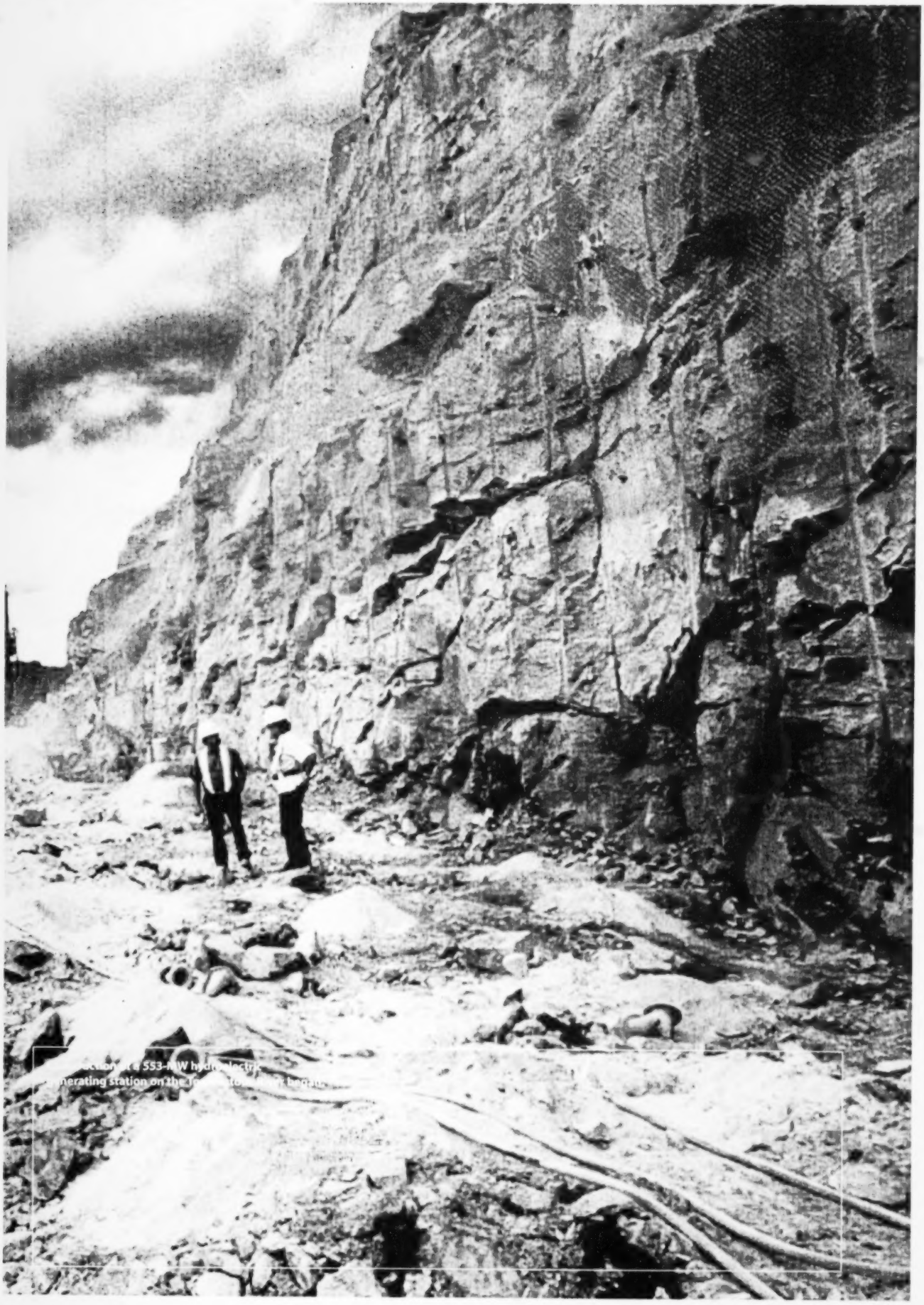
In addition, it offers professional services in the operation, management, refurbishing and optimizing of hydroelectric facilities. In 2002, these activities generated $49.5 million in revenue and $13.8 million in income.

Refinancing of the debt on Fortuna generating station, in Panama, was made possible by an initial bond issue on the U.S., Panamanian and Canadian markets. Hydro-Québec has a 16.3% stake in this facility.

Expertise and Human Resources

An agreement creating 153 permanent jobs was signed with the trade employees' union. These jobs are for seasonal work—from March to November—which is better suited to facility maintenance timetables.
Agreements were signed with the trade employees' and engineers' unions, so that the working conditions of operations employees at Gentilly-2 generating station can be adapted to the new requirements of the Canadian Nuclear Safety Commission.
An agreement between union and management to increase the responsibilities of trade employees was put into effect.
Training in job coaching was given to 139 managers.
Intensive training was provided in the new *Work Safety Code* for 2,908 employees working at Hydro-Québec Production's generating facilities or employed by its contractors.
The work-related accident frequency declined to 4.65 per 200,000 hours worked at year-end, compared with 5.07 in 2001.





HYDRO-QUÉBEC ÉQUIPEMENT AND SEBCI HAVE THE EXPERTISE TO CARRY OUT LARGE-SCALE GENERATION AND TRANSMISSION PROJECTS, BOTH IN QUÉBEC AND BEYOND ITS BORDERS.

2,800 MW

will be added to the company's generating fleet by 2013 through the refurbishing of existing generating stations and the construction of new facilities.

OUR BUSINESS

Designing and Building Hydroelectric Developments and High-Voltage Transmission Lines

Hydro-Québec Équipement offers consulting services in engineering, environment and project management, and acts as general contractor for Hydro-Québec's other divisions, mainly Hydro-Québec Production and Hydro-Québec TransÉnergie. Its role is of key importance to the company, as its expertise contributes directly to Hydro-Québec's performance. By optimizing its procedures and updating its know-how in order to reduce the costs and lead times of the projects entrusted to it, the division enhances its clients' competitive position. Its costs and productivity rate compare favorably with those available on the market.

Hydro-Québec Équipement meets sizable technical and logistical challenges such as the construction and rehabilitation of hydroelectric generating stations in remote regions as well as urban areas, or the construction of high-voltage transmission lines over distances of several hundred kilometres. It must be highly flexible, particularly in refurbishment projects where the client wants to keep production losses, and facility downtime, to a minimum.

Whatever the nature and scope of its assignments, the division systematically applies an environmental assessment process based on knowledge and expertise acquired over more than 30 years.

Hydro-Québec Équipement secures approval for its projects from the competent government authorities and carries them out in agreement with the communities concerned. It also endeavors to optimize the economic and technological spinoffs of its projects in the regions where they are built.

The division operates throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement*. Its volume of activity is closely linked to the projects put forward by the other divisions.

During the year, Hydro-Québec Équipement harmonized its risk analysis system with Hydro-Québec Production's financial analysis system in order to make the generation projects competitive and to support decision making at each project stage.

Provide thermic, electric and engineering services in... and carry out energy related construction projects both nationally and internationally.

Strategic Plan 2002-2006, page 12

Richard Cacchione
President
Hydro-Québec Équipement

Generation

New Developments

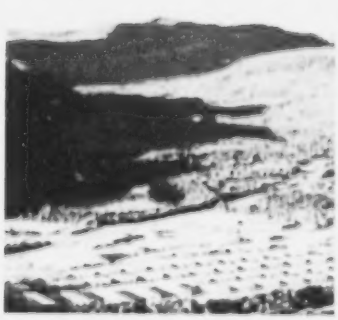
Additional work was carried out at Sainte-Marguerite-3 generating station. This entailed lining and concreting a 330-m section of the headrace tunnel supplying the station's two generating units. In spite of the major technological challenge this involved, the work was completed on schedule. Since construction began on this development in 1994, the North Shore region has benefited from economic spinoffs worth $500 million, or one-quarter of the total outlay.
Construction proceeded on the new hydroelectric generating station at Grand-Mère. Developing this $454-million project in a limited urban space is a considerable challenge.
A camp to house nearly 1,000 people was completed, and construction got under way on the $800-million Toulnustouc generating station.
The partial diversion of the Portneuf and Sault aux Cochons rivers was completed, and approval was obtained from the provincial and federal governments for the partial diversion of the Manouane River.

Refurbishing

The rehabilitation of Beauharnois generating station continued. This $1.5-billion project started up in 1994 and should be completed by 2013. In 2002, the division finished overhauling three generating units and completed construction of the station's east extension, which will serve as the switchyard.
Reconstruction began on the spillways and dams at Chute-Garneau and Pont-Arnaud, in the Saguenay region.
Phase I of flood control at Lake Kénogami was carried out for the Québec government.
Work continued on refurbishing Outardes-3 generating station and replacing its turbines to increase its installed capacity.
The full overhaul of the eight generating units at Bersimis-1 generating station proceeded, with completion slated for 2005.

Draft Design

Draft design studies continued for the development of Péribonka, Rapides-des-Cœurs and Chute-Allard generating stations.
Draft design studies proceeded for the refurbishing and refitting of Outardes-4 generating station and substation.
Draft design studies were completed for the refurbishing of Rapide-2 and Rapide-7 generating stations.



Transmission

New Developments

Construction began on Montérégie substation. This $102-million development is the cornerstone of the Montérégie loop project.

After orders-in-council were obtained from the government, engineering began and calls for tenders were issued for the construction of the 45-km section of the 735-kV Saint-Césaire–Hertel line.

A 50-km, 69-kV transmission line was built between Micoua and Pesamit substations to supply power to the Toulnustouc generating station jobsite and camp.

A 120-kV line was built between Magog and Sherbrooke to increase security of supply in the Magog area.

Refurbishing

A 25-km, 120-kV line was rebuilt between the municipalities of Lachute and Lafontaine to increase security of supply in the Lachute area.

Draft Design

An application was filed with the provincial Department of the Environment for a permit to build a 315-kV line linking Micoua substation and Toulnustouc generating station.

Engineering

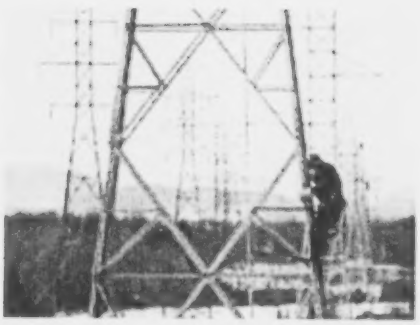
Hydro-Québec Équipement offers engineering services to Hydro-Québec's other divisions in various fields including electricity generation and transmission, grid control and protection systems, and telecommunications.

The division becomes involved in new developments as early as the draft design stage (feasibility studies, concept development and optimization), and then coordinates the detailed project engineering (validation of plans and specifications). It also carries out numerous projects for refurbishing lines, substations and generating stations, and proposes tailor-made solutions for its clients.

To maintain up-to-date expertise, the division participates in technological development projects like Esprit. This program promotes the development of practices that have a direct impact on the reliability and operating flexibility of transmission and generating equipment.

Research continued on ways of improving dam design with an upstream facing made of concrete or roller-compacted concrete, and on modeling stream flows when ice is present.

Construction of a 120-kV line between Magog and Sherbrooke



Environment

In addition to ensuring that projects meet the environmental criteria set by Hydro-Québec and the governments concerned, the division proposes and implements mitigative measures to minimize the impacts of facility construction and operation and to enhance various environmental elements. To accelerate the startup of projects assigned by its clients, it makes great efforts to reduce the time required for the environmental impact assessment and review process.

Under the ISO 14001 action plan, an environmental assessment method was developed to guide impact studies for new hydroelectric developments and facilitate their analysis by the government authorities concerned.

Expertise and Human Resources

Some 30 projects for passing on knowledge in areas of strategic importance for the division were carried out.
An agreement was signed with Québec's Commission de la santé et de la sécurité du travail (CSST), or occupational health and safety board, designed to encourage contractors to manage jobsite safety themselves according to the standards defined by Hydro-Québec, which are recognized as being the highest in the province.

OUR BUSINESS

Providing World-Class Services in Energy-Related Project Engineering and Construction

Société d'énergie de la Baie James (SEBJ) develops projects for Hydro-Québec in the territory governed by the *James Bay and Northern Québec Agreement*, and fulfills contracts obtained through tenders both inside and outside Québec. It has developed construction expertise in remote areas and multicultural environments such as northern Québec and the Peruvian Andes, where it built a 220-kV transmission line at altitudes of 4,000 m or more.

SEBJ works in harmony with the communities concerned. In this way, it can take into account the concerns and views of the users of the land in planning transmission and generating facilities, right from the draft design stage, and establish productive partnerships with them. It shows a constant concern for its projects' impacts on the biophysical and social environments.

Élie Saheb
President and Chief Executive Officer
Société d'énergie de la Baie James

Hydroelectric Development Projects

Under the agreements, the work will be carried out for Hydro-Québec Production by SEBJ in close cooperation with the Cree Nation, which will obtain contracts and benefit from the spinoffs associated with the hydroelectric development of the territory.

These two hydroelectric projects will add 1,250 MW to Hydro-Québec Production's generating facilities. The total project cost is estimated at $4 billion.

SEBJ is responsible for project implementation. Hydro-Québec already has the necessary approvals to build the Eastmain-1 development. It will submit the Eastmain-1-A generating station and Rupert diversion project to the assessment process for environmental and social impacts, as laid out in the *James Bay and Northern Québec Agreement*, with a view to obtaining the necessary approvals for this project. SEBJ is the prime contractor for the project evaluating the hydropower potential of Nunavik, as well.

Eastmain-1 Hydroelectric Development

Construction began on the access road and work camps.
Cree and non-Aboriginal workers from the James Bay region participated in the various stages of the work. Of the 430 workers on the site, one-third are Crees. At the peak of construction, in 2004, the project will provide jobs for 2,400 people.
The project's economic spinoffs were maximized for the Cree and non-Aboriginal local populations.

Eastmain-1-A Generating Station and Rupert Diversion

Technical and environmental studies got under way, in preparation for project approval by the competent authorities. These studies, costing an estimated $60 million, take the Crees' needs and concerns into account and make the most of their knowledge of the region. Three universities and 18 specialized environmental firms are involved in these studies.
An information and discussion panel was set up to consult non-Aboriginal local users of the territory and to seek consensus-based solutions in response to their concerns.

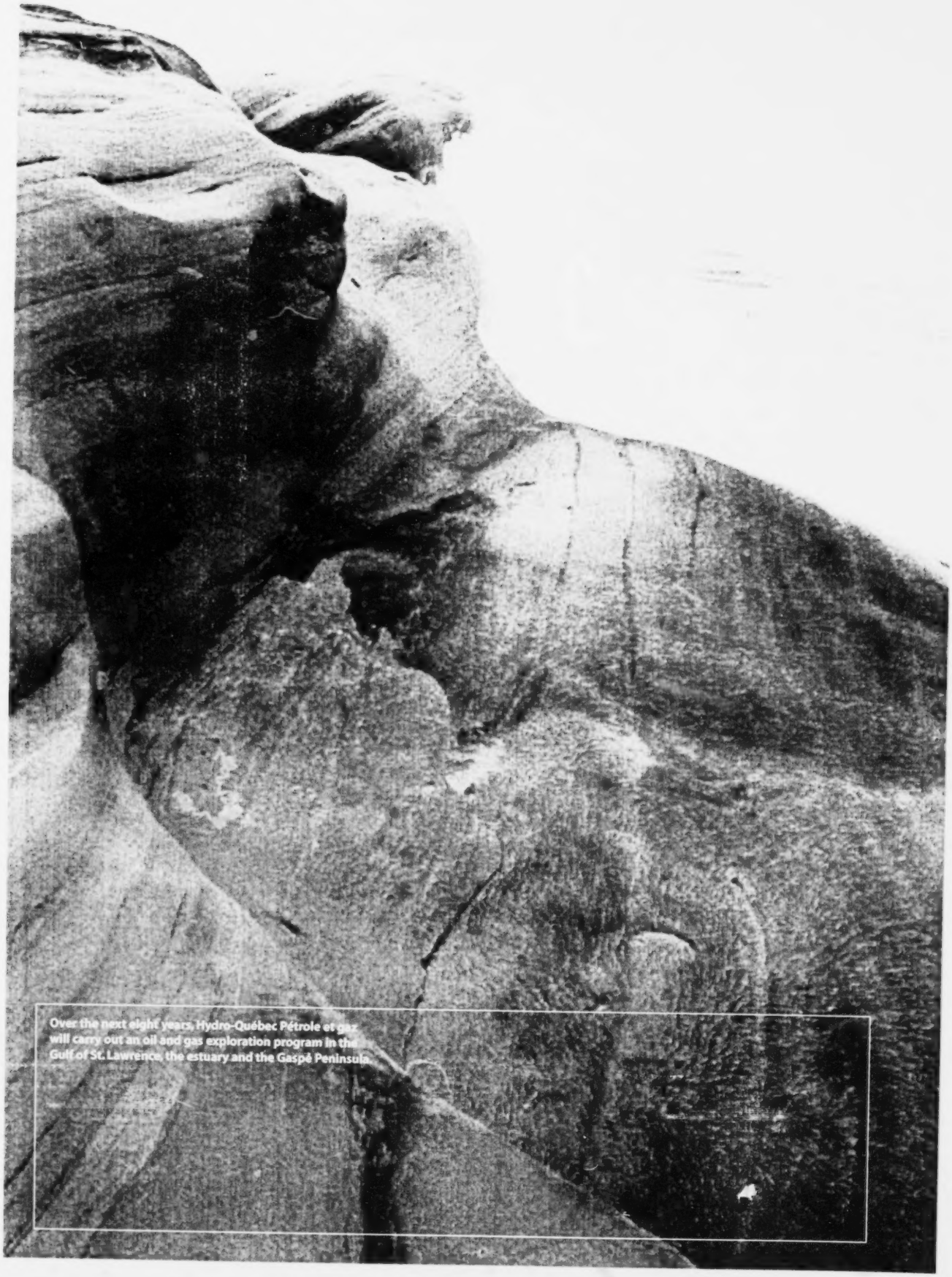
Evaluation of Hydropower Potential in Nunavik

These studies will help determine what developments are possible, on the basis of their technical, economic and environmental feasibility. The projects must also be favorably received by the local communities.

Phase I of studies to determine potential sites on the Nastapoka, Caniapiscau, Baleine (Whale) and George rivers was completed, in partnership with the Inuit communities.
Three Inuit coordinators were designated by Makivik Corporation to communicate with the local communities.
A budget of $7.5 million was committed for the study of the hydroelectric potential of Nunavik in 2002.

Cedars Rapids Transmission Co. Les Cèdres–Cornwall Transmission Line

Construction began on a 230-kV transmission line to replace a 120-kV line dating from 1915, a $41.5-million project obtained further to a call for tenders from Hydro-Québec TransÉnergie.



Over the next eight years, Hydro-Québec Pétrole et gaz will carry out an oil and gas exploration program in the Gulf of St. Lawrence, the estuary and the Gaspé Peninsula.

$330

million will be invested by 2010 in an exploration program, in partnership with world-class companies.

OUR BUSINESS

Exploiting the Oil and Gas Potential of Eastern Québec

In terms of assets and scope of operations, Hydro-Québec is one of the top energy companies in Canada. It plans to maintain its leadership position in order to continue to create wealth and employment for all Quebecers.

Since 1997, Hydro-Québec has had a majority interest in Noverco, a holding company active in the pipelining of natural gas, oil and liquid natural gas and the distribution of natural gas. It is also constantly on the lookout for developments in distributed generation with a view to investing in promising commercial applications for Hydro-Québec, Gaz Métropolitain and their customers.

In 2002, Hydro-Québec embarked on the development of the oil and gas potential of eastern Québec. To cut down on the risks, the exploration work will be done in partnership with companies that have the necessary financial capacity and expertise. Studies by industry specialists have already confirmed the presence of sedimentary zones in the Gulf of St. Lawrence, the estuary and the Gaspé Peninsula. The discovery of major oil and natural gas fields would represent definite commercial value and, in addition, help diversify Québec's energy supply and stimulate the economy in these regions.

"Act as a Catalyst for Québec's oil and gas industry"
Strategic Plan 2002-2006, Addenda of June 2002

Michel Gourdeau
President
Hydro-Québec Pétrole et gaz

Holdings

Noverco, in turn, has a 77.4% stake in Gaz Métropolitain and Company, Limited Partnership, and holds 9.8% of the common shares of Enbridge, the world's largest oil carrier and the largest natural gas distributor in Canada. Through this investment, Hydro-Québec supports the growth strategies of these companies, in particular those that provide it with attractive revenue while benefiting Québec consumers.

Net income from Hydro-Québec's stake in Noverco was $38 million, up $20 million from 2001.
A demonstration project continued, in collaboration with Gaz Métropolitain, on a gas-fired Capstone microturbine operated in cogeneration mode and in parallel with Hydro-Québec's distribution system.

Oil and Gas Exploration

Considering the low rate of reserve replacement and increased use of natural gas in generating electricity, especially in the U.S. Northeast, the market and prices are likely to remain at a level that ensures the profitability of natural gas operations in the coming years.

A decision was made to invest $330 million between now and 2010 in oil and gas exploration in the Gulf of St. Lawrence, the estuary and the Gaspé Peninsula, in partnership with world-class exploration companies.
The construction of the Roland-Giroux building, in Québec City, was announced. Starting in 2005, this building will house Hydro-Québec Pétrole et gaz.
An exploration well was drilled in the Gaspé Peninsula, in partnership with Junex and Gestion Bernard Lemaire.

Hydro-Québec has an international profile.
Its activities yield spinoffs that benefit all Quebecers.

$1.6

billion in purchases of goods
and services in Québec,
benefiting all regions.

Research and Strategic Planning

In a constantly changing industry, Hydro-Québec must take every possible measure to maintain the leadership position it enjoys in the North American energy sector. It draws up strategic plans designed to support its long-term growth based, in part, on R&D in new technologies that improve the divisions' efficiency and profitability. Hydro-Québec also works to commercialize and market the products and services developed in its laboratories. Through its venture capital investments, it forges new business partnerships and identifies the most relevant emerging technologies. The company also monitors discontinuities and technological changes likely to have a long-term effect on its business model or mission, in order to be positioned strategically on tomorrow's market.

Strategic Planning

Hydro-Québec produces a strategic plan that guides its activities over a five-year timeframe, and reevaluates its orientations every two years. The plan is developed in cooperation with the divisions and corporate units, and is submitted to the Board of Directors and then to the Québec government for approval.

The *Strategic Plan 2002–2006* was reviewed by the Québec parliamentary commission on the economy and labor.
Addenda to the Strategic Plan were filed concerning the company's involvement in gas exploration and its support for the development of the wind power industry.
Major changes in the industry were monitored and analyzed, so that the best choices could be made and development opportunities targeted.

Technological Innovation

Hydro-Québec's R&D activities have two objectives: improve the divisions' performance and reposition the company strategically for the long term.

Technological innovation has a decisive impact on the efficiency of the company's divisions and enables them to sharpen their competitive edge. In addition, some technologies developed to meet the divisions' needs offer marketing potential that could enhance the company's financial performance. All R&D projects revolve around issues identified by the divisions and are directly related to improving their operations.

Following an in-depth exercise involving a large number of energy experts, the company drew up a technological roadmap. This map identifies breakthrough technologies with a significant impact on its current business model, notably in the areas of distributed generation, management of the power system and its limits, wind power and its use within the system, and energy efficiency. Hydro-Québec is also a member of the OURANOS consortium, made up of scientists whose research is devoted to analyzing the phenomena, issues and scenarios related to climate change in North America.

Various innovations such as low-emission power generation are already exerting pressure on the energy industry and will gradually affect the market. Hydro-Québec's ability to rapidly integrate emerging technologies into its operations will help it maintain its technology leadership.

To achieve these objectives, the company devoted $107 million in 2002 to R&D activities conducted mainly by Hydro-Québec's research institute, which has world-renowned expertise in electricity generation and transmission.

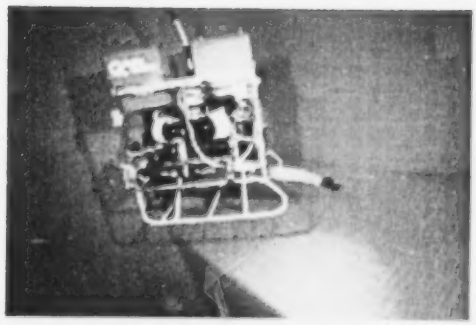
R&D – Hydro-Québec Distribution
A new concept was developed for an underground distribution grid that operates at an intermediate voltage of 600 V, considerably reducing line burial costs. Energy efficiency projects were carried out.

R&D – Hydro-Québec Production
At Chelsea and Paugan generating stations, the first prototype of an inspection robot for submerged structures was put into service, making divers' work safer.

R&D – Hydro-Québec TransÉnergie
A new type of digital multiband stabilizer was developed. By efficiently absorbing all electromechanical oscillations caused by disturbances on the system, this device contributes to improving system stability.

Corporate Venture Capital

Hydro-Québec CapiTech is a wholly owned venture capital subsidiary of Hydro-Québec set up to give the company a better understanding of energy-related products and services and enable it to take advantage of new business opportunities. It makes strategic investments in companies with products and services likely to foster the growth of Hydro-Québec operations or improve the divisions' performance. The prospect of an acceptable financial return is a fundamental criterion in the choice of investments. Hydro-Québec CapiTech aims for a long-term return that is at least equivalent to the median for similar venture capital funds. However, the continued weakness in financial markets in 2002 meant a widespread decline in value and return for the entire venture capital industry. Hydro-Québec CapiTech was no exception, and its portfolio also fell in value. At December 31, 2002, it managed an investment portfolio worth $181 million, of this total, $167 million represented amounts invested in capital venturing (funds I and II and the Innovation Fund).



Hydro-Québec CapiTech managed 37 direct and indirect investments in its venture capital portfolio. Substantial efforts were made to identify and evaluate portfolio investments that present the greatest potential for value in the short term.

Direct investments and reinvestments totaled $23.4 million, compared with $30.9 million in 2001, including $14.5 million in seven new companies: Alternative Green Energy Systems, Azure Dynamics Corporation, CellTech Power, Harfang Microtechniques, Intellon Corporation, iPower Technologies and Solena Group.

Partnerships were maintained with the American funds Nth Power and EnerTech and the European SAM Private Equity Energy Fund, for total indirect reinvestments of $4.7 million.

Technological monitoring was stepped up, emphasizing the creation of value for Hydro-Québec's divisions, whether in increased revenue, lower costs, improved productivity or extended useful life for facilities.

Commercialization of Hydro-Québec Technologies

Hydro-Québec IndusTech managed a portfolio dedicated to marketing technologies that offer new avenues for longer-term growth:

AVESTOR, a joint venture of Hydro-Québec and Kerr-McGee Chemical, opened its first plant in Boucherville. This plant produces commercial quantities of lithium-metal-polymer (LMP) batteries, in particular for the telecommunications and automotive markets, and potentially for power producers and distributors.

Three partnering arrangements were signed, allowing Technologies M4 to concentrate on the development and marketing of electric motorization systems and on distributed power generation.

The ESEV (Energy Systems for Electric Vehicles) project was launched. Its goal is to develop a fully electric vehicle using AVESTOR's LMP battery technology and certain components of the technology developed by Technologies M4, namely the electric traction chain and vehicle management electronics.

Human Resources and Shared Services

Human Resources and Shared Services, a corporate group created in 2002, brings together the main support functions so that the divisions can devote all their efforts to their core operations.

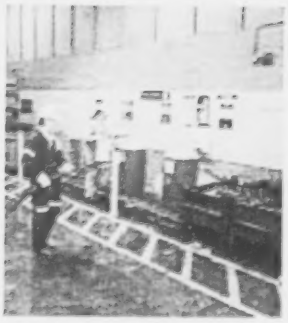
The Shared Services Centre combines the following areas of activity: computer-based solutions, IT operations, office automation systems, hardware, acquisitions, transportation services, document management and real estate.

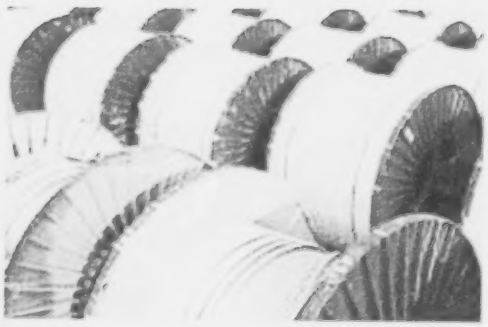
The Human Resources Directorate develops and manages employee succession, recruitment, training and motivation programs. In addition, it negotiates labor agreements with the employees' representatives. Together with the divisions, it is also responsible for occupational health and safety.

Shared Services

The Shared Services Centre came into being through the merger of Procurement and Services with Information Technologies. It is in charge of developing partnerships with its client divisions and corporate units, in order to enhance their financial performance and facilitate the achievement of their objectives. In spite of the many changes that marked 2002, the Shared Services Centre maintained the quality of services provided to clients, while continuing the improvements instituted in recent years.

Agreements worth over $600 million were signed for the provision of services to internal clients.
Selection criteria were established for the computer platform that will support the upgrading of Hydro-Québec Distribution's customer information systems.
Power generators were installed to supply Hydro-Québec's administrative buildings in emergencies.
Some 10,127 tonnes of residual hazardous materials were recovered from all over Québec; more than 85% of this total was used for energy recovery.
Specific provisions were included in supplier contracts to ensure compliance with Hydro-Québec's environmental and social standards.
ISO 14001 certification was maintained by the four territories connected with the Shared Services Centre.





Acquisition of Goods and Services

In 2002, in accordance with the policy "Our Acquisition of Goods and Services," Hydro-Québec kept up its initiatives to ensure security of supply in the goods and services needed to fulfill its core mission. Among other things, the company signed 55 procurement agreements with suppliers of strategic goods.

Suppliers of strategic goods and services were also informed that they will have to comply with the new ISO 9001:2000 quality standard beginning in 2004.

The company identified the goods and services likely to be covered by new medium- and long-term agreements with its suppliers. Accordingly, it signed 20 new framework agreements with commodity suppliers, relating to seven new product categories.

Lastly, Hydro-Québec continued to manage its procurement procedures with great care, integrity and transparency. The number of complaints and claims filed with the Procurement branch by external suppliers and organizations declined from 36 in 1999 to 18 in 2002.

Goods and services worth a total of $1.8 billion were acquired: $741 million in goods, $25 million in rentals, $747 million in specialized services and other work, and $289 million in professional services. Savings of $124 million have been achieved since January 2000.
The division contributed to sustaining the Québec economy, as 91% of goods and services were purchased from Québec-based suppliers.

Hydro-Québec Acquisitions by Administrative Region (2002)

Bas-Saint-Laurent (01)	1,754	5,821	7,575
Saguenay—Lac-Saint-Jean (02)	37,706	37,235	74,941
Capitale-Nationale (03)	39,143	65,152	104,295
Mauricie (04)	22,616	53,374	75,990
Estrie (05)	3,051	5,387	8,438
Montréal (06)	305,184	372,177	677,361
Outaouais (07)	6,099	8,400	14,499
Abitibi-Témiscamingue (08)	10,703	18,911	29,614
Côte-Nord (09)	16,882	64,991	81,873
Nord-du-Québec (10)	3,430	7,337	10,767
Gaspésie—Îles-de-la-Madeleine (11)	612	2,406	3,018
Chaudière-Appalaches (12)	9,872	45,104	54,976
Laval (13)	12,147	61,799	73,946
Lanaudière (14)	17,417	17,699	35,116
Laurentides (15)	15,095	65,050	80,145
Montérégie (16)	145,645	111,276	256,921
Centre-du-Québec (17)	12,875	46,358	59,233
Total	**660,231**	**988,477**	**1,648,708**

a) Amounts billed by suppliers located in the administrative region.
b) Purchase and rental of goods.
c) Specialized services, professional services and other work.

Human Resources

The Human Resources Directorate ensures that Hydro-Québec has the skilled, motivated workforce it needs to fulfill its mission. It supplies the company's divisions and other units with the necessary guidelines and tools for managing their human resources.

The highest overall employee satisfaction level ever recorded at Hydro-Québec was achieved: 8.11 out of 10, an increase of 0.08 over the previous year.
The employee motivation index also rose to its highest level ever: 6.69 out of 10, an improvement of 0.05 from the previous year.
Activities surrounding the 2001–2006 corporate succession support plan were stepped up and expanded.
The work-related accident frequency fell to 3.60 per 200,000 hours worked, compared with 4.07 in 2001.
The employee assistance program was introduced, providing free and confidential professional assistance to employees faced with problems.
The pay equity program was implemented for seven groups of unionized employees and for non-unionized employees.
The collective agreement with the Hydro-Québec specialists' union, CUPE (FTQ) local 4250, was renewed.

Environment

Hydro-Québec is a leader in environmental protection. Since the early 1970s, it has devoted substantial efforts to studying the host areas where its facilities are built in order to mitigate the environmental impact of its activities. In recent years, it has also carried out many projects to enhance Québec's ecological heritage.

With its hydroelectric generating stations, Hydro-Québec produces clean, renewable energy, thus contributing to lower pollutant emission levels in Québec. As well, its electricity sales outside Québec imply a reduction in the use of thermal generating facilities in neighboring states and provinces, and a corresponding improvement in air quality throughout northeastern North America.

To expand its long-term support for environmental protection initiatives, the company established the Fondation Hydro-Québec pour l'environnement in 2001. The non-profit Foundation provides financial assistance for projects that have major environmental spinoffs and meet local needs. Additionally, Hydro-Québec supports three university environmental research chairs and participates in numerous programs and studies, together with partners in the public and private sectors.

The *Summary of Knowledge Acquired in Northern Environments from 1970 to 2000* was widely distributed. This publication provides an overview of knowledge acquired in the last 30 years through environmental follow-up programs and studies examining the aquatic, terrestrial and social environments of northern Québec. Published in 2001, the Summary highlights Hydro-Québec's contribution to the development of environmental sciences in Québec.
ISO 14001 certification was obtained for the environmental management systems of Hydro-Québec TransÉnergie and the LTE energy technology laboratory. To date, 11 administrative units, with a total of 15,200 employees, have earned this certification.
A total of $829,850 was committed to the 11 projects selected out of 53 presented to the Foundation. Hydro-Québec donated two of its properties—some of the islands in the Lachine Rapids and a 15-km section of the Richelieu River bed—to the Québec office of the Nature Conservancy of Canada, allowing the creation and management of two important conservation areas and wildlife preserves.
The company received a Hydro Achievement Award presented by the U.S. National Hydropower Association. This recreational stewardship award recognized a variety of projects facilitating access to the Saint-Maurice River, in connection with the refurbishing of four generating stations and the construction of the new facility at Grand Mère.

Community Involvement

Hydro-Québec plays a part in the economic development of Québec through its province-wide activities, which generate substantial spinoffs. It also supports numerous causes by contributing to organizations involved in health, education and humanitarian aid. The company devotes a considerable amount of money to sponsoring events, particularly in the socioeconomic, cultural, environmental and sustainable development spheres, as well as amateur sport.

Hydro-Québec employees and pensioners made a significant contribution to The United Way, to which they gave over $2,239,000 in 2002. As it does every year, the company matched this amount, bringing the total donation to $4.5 million. Another $350,000 was given directly to other organizations that help those in need.

Hydro-Québec encourages its employees to get involved in the community by providing up to $1,000 to the community organizations they support. In all, 220 employees participated in this program in 2002, and the company's contributions totaled $183,000.

Health and Humanitarian Aid
The company supported research activities at Québec university hospital centres and other major institutions such as the Montréal Heart Institute, the Montréal university geriatric institute and the Robert-Giffard hospital research centre in Beauport.
Assistance was provided for many patient-support organizations.

Education
The company sponsored 20 research chairs at various Québec universities, mainly in the technology, social, health and environment fields.
A contribution of $20,000 was made to the Université du Québec foundation, for scholarships designed to encourage the next generation of professionals in energy-related fields.
Scholarships and internships at Hydro-Québec were awarded to six Aboriginal students at the college and university levels.
Hydro-Québec renewed its commitment to the Conseil de développement du loisir scientifique and its sponsorship of the Québec delegation at the International Science Fair in order to get young people interested in careers in science and technology.

The company sponsored the Science and Technology pavilion at the 2002 Education Training Career Fair, which featured a solar vehicle unveiled by McGill University's Team iSun, an electric vehicle and a model of the new Grand-Mère generating station jobsite.
It renewed its support for the Québec Literacy Foundation through its participation in the Gift of Reading initiative and its contribution to the Info-Alpha line, a service that helps adults obtain basic literacy training.

Culture

The mural created by Jean-Paul Mousseau for the lobby of Hydro-Québec's head office building, and inaugurated in 1962, was re-lit.
Support was continued for the Petite-Vallée song festival.
Support was provided for the 25th season of the Festival international de Lanaudière.
Hydro-Québec renewed its commitment for the next three seasons to the Orchestre symphonique de Montréal, for which it is the title sponsor.
Two of the prizes awarded by the society to promote French song (SACEF) in its competition *Ma première Place des Arts* were sponsored by Hydro-Québec.
The Théâtre Les Amis de chiffon, in the Saguenay region, was sponsored.
The Centaur Theatre Company was sponsored for the third consecutive year.
The company sponsored the Drummondville festival of world culture.
During the FrancoFolies de Montréal, it organized the Spectacles multiculturels Hydro-Québec event, which attracted performers from many countries.
The Essor awards were given out, with 16 regional prizes of $1,000 each and a $5,000 provincial first prize donated by Hydro-Québec. This contest aims at encouraging talented new artists.

Sports

The company sponsored the 19th sports challenge competition for athletes with disabilities.
Young amateur athletes were awarded 18 scholarships worth $3,000 each.

Socioeconomic Activities

Hydro-Québec took part in activities organized by the International Association of Science Parks and Les Jeunes Entreprises du Québec, as well as in the Conference of Montreal, the Grands Prix du tourisme québécois and the Saturn awards given out by the Fédération des agricultrices du Québec.
It participated in the Inuit Circumpolar Conference organized by the Kativik Regional Government and the municipality of Kuujjuaq.

International Role

Through its participation in international cooperative projects, Hydro-Québec shares its knowledge and expertise with electric utilities, governmental organizations and national associations in developing countries, and contributes to the growth of the power industry around the world.

Some 20 projects were carried out in 12 French-speaking countries, mainly in the area of vocational training in environmental and management issues.

Hydro-Québec's collaborative effort with the Institut de l'énergie et de l'environnement de la Francophonie continued, and 13 projects were completed in 10 non-francophone countries.

Hydro-Québec took part in the World Summit on Sustainable Development in Johannesburg as a member of the e7, an organization established in 1992 on the initiative of Hydro-Québec and Électricité de France. The e7 is made up of nine leading electricity companies in the G7—the world's most industrialized countries—which are determined to play an active role in the international debate on the environment and sustainable development.

At the World Summit, the e7 signed agreements with the United Nations and its main agencies for private-public partnerships set up to provide electricity to people around the world who do not yet have access to it.

A sector-based report on the power industry's achievements and challenges since 1992 was presented by the United Nations Environment Program at the World Summit. The report was drafted by American Electric Power, Électricité de France and Hydro-Québec.

A series of seminars was held to allow Thai authorities to develop the tools to plan and carry out power-related environmental activities (air quality, noise assessment, public participation, environmental management, etc.).

Hydro-Québec organized the International Conference on Energy as part of the Conference of Montreal. The event dealt with investment in the energy industry, and drew a large delegation from Chile, including the chair of that country's national electricity commission and the chairs of the parliamentary committees in charge of energy.

The company took part in the 2002 Entretiens Jacques-Cartier, on the topic of e-learning.

NET INCOME REACHED $1.5 BILLION, UP $418 MILLION FROM THE REPORTED FIGURE FOR 2001.

Contents

Management's Discussion and Analysis
Consolidated Financial Statements
Management Report
Auditors' Report
Consolidated Statement of Operations
Consolidated Statement of Retained Earnings
Consolidated Balance Sheet
Consolidated Statement of Cash Flows
Notes to Consolidated Financial Statements
Supplementary Information

Overview

Net income stood at $1,526 million in 2002, up $418 million from net income reported in 2001.

The restatement required under the new foreign currency translation accounting standard increased 2001 financial expenses by $513 million and reduced 2001 net income by the same amount.

Revenue totaled $13 billion, up 3.4% from 2001. This growth was fueled by a solid business performance across all markets.

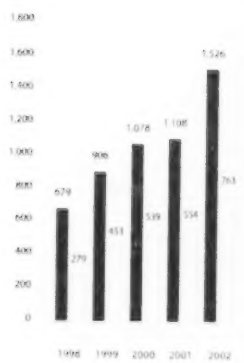
Financial expenses declined by $307 million or 9.2% compared with the amount reported in 2001. This significant reduction was achieved through active debt management at a time of declining interest rates.

Return on equity rose significantly to 11.0% in 2002, surpassing the objectives of the *Strategic Plan 2002–2006*. It thus exceeded the average cost of debt, which stood at 8.4%. Return on revenue was 11.7%.

Funds from operations grew by 10.1% to $3.8 billion and were used to finance the investment program and reduce long-term debt by $514 million. If not for the $500 million in prefinancing carried out in 2002 for activities in 2003, the amount repaid on the debt would have topped $1 billion.

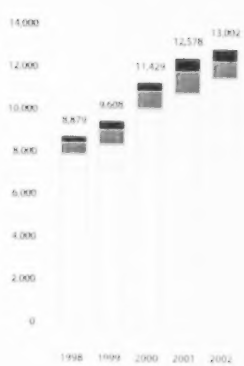
Dividends of $763 million will be paid to our shareholder, the sixth such payment in as many years, bringing the total amount paid out since 1997 to $2.9 billion.

Reported Net Income and Dividends Paid
($M)



Reported net income
Dividends paid

Revenue
($M)



Electricity sales in Québec
Electricity sales outside Québec
Gas sales
Other

Average Cost of Debt and Return on Equity*
(%)

Average cost of debt
Return on equity

* *Figures for 1998 to 2001 are based on the reported amounts.*

Consolidated Results

Management's Discussion and Analysis reports on Hydro-Québec's operating results and consolidated financial position, and includes a presentation of segmented results and investments.

In our analysis, Hydro-Québec means the group constituted by the publicly owned corporation Hydro-Québec (the "Corporation") and the companies in which the Corporation holds an interest, including its subsidiaries.

OPERATIONS AND DIVIDENDS ($M)	
Revenue	13,002
Net income	1,526
Dividends	763
BALANCE SHEET ($M)	
Total assets	59,078
Fixed assets	49,694
Long-term debt	36,699
Shareholder's equity	14,215
FINANCIAL RATIOS	
Return on equity (%)	11.0
Average cost of debt (%)	8.4
Return on revenue (%)	11.7
Capitalization (%)	26.2
Self-financing (%)	71.6
Interest coverage	1.56

Unprecedented Operating Results

In 2002, Hydro-Québec continued to focus on its objectives of profitability and the creation of wealth for its shareholder and Québec society. Its net income reached $1,526 million, up $418 million from the amount reported the preceding year. Lower financial expenses and significantly higher sales explain this growth. As a result of its solid financial performance, Hydro-Québec was able to appreciably improve all of its financial ratios. Return on equity reached 11.0% and interest coverage stood at 1.56 in 2002.

Sales amounted to $13 billion, well ahead of the *Strategic Plan 2002–2006* forecasts, and were up $424 million from 2001. Hydro-Québec deftly capitalized on business opportunities and favorable economic conditions in Québec. Hydro-Québec Production's sustained activity on U.S. and Ontario markets resulted in a $438-million increase in short-term sales; moreover, Hydro-Québec Distribution's efforts to meet rising electricity demand in Québec generated additional revenue of $230 million. However, sales by Hydro-Québec Pétrole et gaz declined by $217 million, primarily due to the decrease in the market price of natural gas. The price fluctuations did not affect Hydro-Québec's gross margin, however, as the same price decreases applied to gas purchases.

Total expenditure stood at $8,403 million, up $301 million or 3.7% from 2001. This increase is largely due to the rise in depreciation, amortization and decommissioning expense, which climbed to $2,062 million from $1,845 million in response to many factors besides the commissioning of facilities and the use of the sinking fund method of depreciation. We added $63 million to the provision for decommissioning of Gentilly-2 nuclear generating station to reflect imputed interest, for purposes of harmonization with the *Act Respecting the Long-Term Management of Nuclear Fuel Waste*. In addition, depreciation and amortization expense rose by $37 million as a result of the annual review of the status of suspended draft design projects and by a further $29 million with the end of the application of regulatory accounting practices for unregulated activities.

Financial expenses amounted to $3,043 million, $307 million or 9.2% lower than the figure reported in 2001. This decrease reflects the long-term debt repayments and lower interest rates of recent years. Interest rates started to drop in 2001, continued their downward trend through the first quarter of 2002, then remained stable. The rate for three-month Canadian banker's acceptances fell from 4% to 2.6%, and the three-month London Interbank Offered Rate (LIBOR) dropped from 3.8% to 1.8%. Management of the variable portion of the debt, kept at approximately 25% of total debt, allowed us to take advantage of the lower short-term rates. Lastly, this year, we again carried out our refinancing transactions at rates below those for redemptions.

It should be kept in mind that the 2001 financial expenses have been adjusted upward by $513 million to reflect the retroactive application of the new accounting standard on foreign currency translation. This standard eliminates the deferral and amortization of foreign exchange gains and losses related to unhedged foreign-denominated monetary items, and requires that from now on such gains or losses be recognized immediately in the year's income.

At the end of 2001, we adapted our foreign exchange risk management strategy to offset any income volatility that could have been caused by application of the new standard. Although the average Canadian dollar exchange rate fell from US$0.646 in 2001 to US$0.637 in 2002, the decrease had only a minor effect on the statement of operations. Because the standard was applied retroactively, the impact of our new strategy was only felt in 2002.

Financial Position

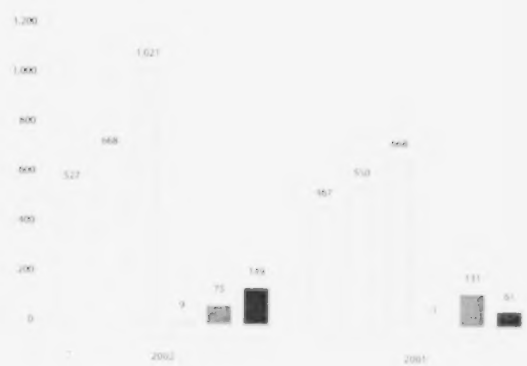
Operating Activities

Operating activities generated cash of $3.8 billion in 2002, up $349 million or 10.1% over the preceding year. This cash was used to finance investments by Hydro-Québec totaling $2.4 billion and to pay down debt. The self-financing ratio therefore stood at 71.6% at year-end compared with 54.6% at the end of the preceding year.

Investing Activities

In 2002, Hydro-Québec's investments totaled $2,449 million compared with $1,878 million in 2001, an increase of $571 million or 30.4%. This increase largely derives from investments in generating facilities— in particular, the new Grand-Mère hydroelectric development, Toulnustouc generating station, the Eastmain-1 development, the Eastmain 1-A generating station and Rupert diversion draft design project, and Sainte-Marguerite-3 generating station— as well as work on the transmission grid and distribution system extensions to connect new customers. Most generation and transmission projects are carried out by Hydro-Québec Équipement and Société d'énergie de la Baie James (SEBJ), which are tasked with providing engineering and construction services to Hydro-Québec's operating divisions. Lastly, Hydro-Québec invested $313 million through its subsidiaries, including TransÉnergie U.S., which applied a third of this amount to the completion of a high-voltage underwater transmission line between southwestern Connecticut and Long Island, New York. Other investments were primarily made in the Oil and Gas segment, through the subsidiary Noverco, and by Hydro-Québec International.

Investments by Operating Segment
($M)



Financing Activities

The borrowing program was more restrained in 2002 than in 2001. The initial program anticipated borrowings of $1,530 million, a decrease of more than $2 billion compared with 2001. As it turned out, total borrowings amounted to $1,970 million as at December 31, 2002, after the Corporation carried out a $500-million year-end prefinancing transaction to reduce the borrowing program for the first months of 2003. For the fourth straight year, the Corporation recorded a net repayment of long-term debt. The repayment in 2002 amounted to $514 million, bringing the total cumulative amount repaid to $2,287 million. Had it not been for the prefinancing transaction in 2002, the net repayment of long-term debt would have exceeded $1 billion in 2002.

For the past few years, financing costs have generally been lower on the Canadian market than on international markets. Consequently, all financing transactions have been carried out in Canada.

Financing activities were wholly concentrated in the medium-term note market. Over the year, the Corporation issued $791 million in floating-rate notes with a maximum maturity of five years.

In August, the Corporation also capitalized on favorable market conditions and low interest rates to issue an additional $500-million tranche of medium-term notes maturing in 2035 and bearing interest at 6.5%. A second tranche of notes in this series was issued for an amount of $500 million in November. The series' nominal value consequently rose to $1,294 million. The proceeds from the second tranche were used for the prefinancing.

The Corporation also redeemed securities maturing in 2003, in order to reduce the volume of redemptions to be refinanced in the first six months of 2003. The nominal value of the redeemed securities was $447 million. Redemptions at the very beginning of the year, amounting to $186 million, were basically financed through the issuance of floating-rate medium-term notes with slightly longer maturities (2004 to 2006). The securities redeemed in September, totaling $261 million, were financed from funds from operations.

Changes in the Corporation's Long-Term Financing
($M)

SHORT-TERM FINANCING

The Corporation has access to the following preauthorized funding sources:

Type of financing	Authorized volume	Market	Outstanding at December 31, 2002
Credit	US$350M or equivalent in C$	Canada	–
	C$40M	Canada	–
	US$50M	United States	–
Standby credit	US$1,500M	Eurodollar	–
Commercial paper	US$2,250M or equivalent in C$	United States Canada	 C$44M

CREDIT RATINGS

The following table summarizes the Corporation's credit ratings:

	2002	2001
U.S. agencies		
Moody's	A1	A1
Fitch Ratings	AA-	AA-
Standard & Poor's	A+	A+
Canadian agency		
DBRS	A	A

DIVIDENDS AND CAPITALIZATION

With a year-end capitalization of 27.2%, Hydro-Québec declared dividends of $763 million, or 50% of net income. After the dividends have been paid to the shareholder, capitalization will stand at 26.2%, compared with 26.8% reported in 2001. This decline is largely due to the restatement of retained earnings required by the retroactive application of the new accounting standard on foreign currency translation.

Segmented Information

The new North American regulatory environment prompted Hydro-Québec to create Hydro-Québec TransÉnergie in 1997 to comply with the trade rules of the North American wholesale market. In 2001, Hydro-Québec set up three new divisions: Hydro-Québec Distribution, Hydro-Québec Production and Hydro-Québec Ingénierie, approvisionnement et construction.

In 2002, Hydro-Québec Ingénierie, approvisionnement et construction was replaced by Hydro-Québec Équipement, which is charged with carrying out all of the Corporation's major projects, particularly in generation and transmission, except projects in the territories of James Bay and Nunavik, which are the responsibility of the subsidiary SEBJ. Hydro-Québec Équipement and SEBJ henceforth constitute the Construction segment. Activities related to the supply of goods and services, including those pertaining to information technology, have been assigned to the Shared Services Centre, whose operations now fall under Corporate and Other Activities. In addition, a new division, Hydro-Québec Pétrole et gaz, was created. The new structure has given rise to the following breakdown of activities:

Distribution: Hydro-Québec Distribution develops and operates the Corporation's distribution system and is responsible for sales and service to Québec customers.

Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's transmission system in Québec, in addition to managing and operating foreign transmission systems and carrying out development projects. The division also manages Hydro-Québec's telecommunications network.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities in Québec and a number of foreign facilities. It also sells electricity on external markets and engages in energy trading activities. In addition, it participates in the Québec wholesale market by responding to calls for tenders from Hydro-Québec Distribution.

Construction: Hydro-Québec Équipement and SEBJ provide engineering services and carry out construction projects in Québec and in other parts of the world.

Oil and Gas: Hydro-Québec Pétrole et gaz comprises all activities related to the pipeline transmission of oil, natural gas and liquid natural gas, as well as gas distribution. Activities arising from the Québec Oil and Gas Exploration Plan 2002–2010 are also included in this segment.

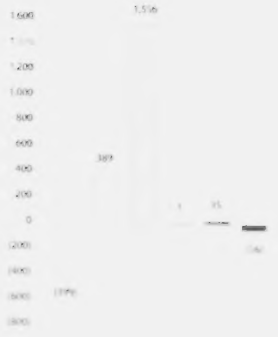
Corporate and Other Activities: This heading covers corporate activities such as financial services, human resources, strategic planning and corporate affairs, as well as the activities managed by the Shared Services Centre, research and development, capital venturing and the commercialization of Hydro-Québec technologies.

The segmented results are presented in note 20 to the financial statements.

Operating Segments

	DISTRIBUTION	TRANSMISSION	GENERATION
REGULATORY ENVIRONMENT	Activities regulated by the Régie de l'énergie Cost-based regulation Rates set by the Québec government in 1998 and maintained through April 2004	Activities regulated by the Régie de l'énergie Cost-based regulation Final decision rendered by the Régie in January 2003 allowing a rate increase retroactive to January 1, 2001	Heritage pool electricity for Québec customers: maximum annual volume of 165 TWh at 2.79 cents per kWh Over this volume and outside Québec: unregulated
MAIN CUSTOMERS OR MARKETS (AS A % OF REVENUE)	Québec markets – electricity: 99% Unregulated: 1%	Hydro-Québec Distribution: 76% Other wholesale markets: 9% International market: 8% Other: 7%	Hydro-Québec Distribution: 62% Other wholesale markets: 36% International market: 2%
	CONSTRUCTION	**OIL AND GAS[1]**	**CORPORATE AND OTHER ACTIVITIES**
REGULATORY ENVIRONMENT	Not applicable	Most operating activities of GMCLP are subject to monitoring and control by the Régie de l'énergie	Not applicable
MAIN CUSTOMERS OR MARKETS (AS A % OF REVENUE)	Hydro-Québec Production: 59% Hydro-Québec TransÉnergie: 32% Other: 9%	GMCLP markets subject to regulation: 97% Unregulated GMCLP activities: 3% (Energy and other services)	All Hydro-Québec Units

Net Income
($M)



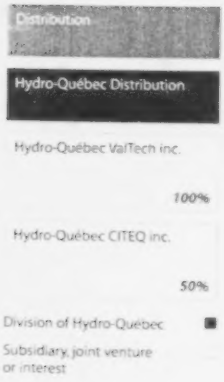
Revenue*
($M)

Total Assets*
($M)

Distribution
Transmission
Generation
Construction
Oil and Gas
Corporate and Other Activities

* Before intersegment reclassifications and eliminations.

1 Hydro-Québec Pétrole et gaz essentially consists of an interest in Noverco. Noverco wholly owns Gaz Metropolitain, Inc., whose main subsidiary, Gaz Metropolitain and Company Limited Partnership (GMCLP), is primarily active in the pipeline distribution of natural gas.



DISTRIBUTION

Operating Results

Hydro-Québec Distribution ensures service quality and reliability for Québec customers. In 2002, to guarantee a reliable supply of electricity, the division carried out an initial long-term call for tenders to satisfy the portion of Québec demand that will exceed the heritage pool of 165 TWh as of 2006–2007. The winning bidders will provide Hydro-Québec Distribution with the means to meet the requirements of the Electricity Supply Plan approved by the Régie de l'énergie.

In July 2002, the division filed an application with the Régie de l'énergie for approval of the cost of distribution services as well as certain regulatory and accounting principles. A decision is expected in the spring of 2003.

The division's net loss stood at $399 million this year, representing a $134-million improvement over 2001. This improvement is mainly due to division sales and purchases of electricity, which contributed an additional $122 million to the profit margin compared with 2001.

Hydro-Québec ValTech oversees the division's unregulated activities and markets technologies related to Hydro-Québec Distribution's core mission. In 2002, it posted net income of $4.8 million.

Electricity Sales in Québec

	Sales			Sales revenue		
	2002	2002 vs 2001		2002	2002 vs 2001	
	TWh	TWh	%	$M	$M	%
Residential and farm	**53.2**	2.4	4.7	**3,246**	115	3.7
General and institutional	**31.7**	1.3	4.3	**2,058**	85	4.3
Industrial	**68.6**	2.3	3.5	**2,577**	95	3.8
Other	**4.8**	0.1	2.1	**223**	6	2.8
Total	**158.3**	6.1	4.0	**8,104**	301	3.9

SIGNIFICANT GROWTH IN ELECTRICITY SALES IN QUÉBEC

In 2002, Québec's solid economic performance, coupled with colder temperatures in the last quarter, drove up electricity sales in the province by 6.1 TWh or 4.0% compared with 2001, pushing total sales to $8,104 million as at December 31, 2002.

REGULATORY ENVIRONMENT	Activities regulated by the Régie de l'énergie Cost-based regulation Rates set by the Québec government in 1998 and maintained through April 2004	Activities regulated by the Régie de l'énergie Cost-based regulation Final decision rendered by the Régie in January 2003 allowing a rate increase retroactive to January 1, 2001	Heritage pool electricity for Québec customers: maximum annual volume of 165 TWh at 2.79 cents per kWh Over this volume and outside Québec: unregulated
MAIN CUSTOMERS OR MARKETS (AS A % OF REVENUE)	Québec markets – electricity: 99% Unregulated: 1%	Hydro-Québec Distribution: 76% Other wholesale markets: 9% International market: 8% Other: 7%	Hydro-Québec Distribution: 62% Other wholesale markets: 36% International market: 2%
REGULATORY ENVIRONMENT	Not applicable	Most operating activities of GMCLP are subject to monitoring and control by the Régie de l'énergie	Not applicable
MAIN CUSTOMERS OR MARKETS (AS A % OF REVENUE)	Hydro-Québec Production: 59% Hydro-Québec TransÉnergie: 32% Other: 9%	GMCLP markets subject to regulation: 97% Unregulated GMCLP activities: 3% (Energy and other services)	All Hydro-Québec units

Hydro-Québec Distribution

DISTRIBUTION

Operating Results

STRONG GROWTH IN DEMAND

The growth in revenues from Québec electricity sales largely reflects a 4.3-TWh or $230-million demand increase, fueled by the recovery of several Québec economic sectors in 2002.

Demand from industrial customers showed the strongest growth, with a 2.2-TWh increase in sales adding revenue of $98 million. This growth was mainly driven by the arrival of major new customers in the pulp and paper and metal smelting and refining industries in the third quarter of 2001. Also, the upswing in the manufacturing sector boosted demand from small- and medium-power industrial customers.

Rising employment and low interest rates, coupled with a high rental occupancy rate, spurred residential construction, which continued to be a driver of economic growth in Québec. These factors also bolstered household confidence and consumption. Demand in the residential/farm and general/institutional categories grew by 1.1 TWh and 0.9 TWh, or $67 million and $62 million, respectively.

MORE SEASONAL TEMPERATURES

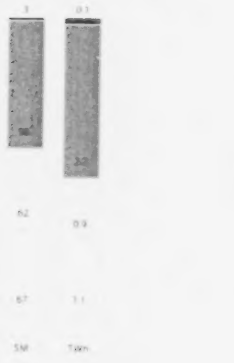
This year's colder temperatures, especially in the last quarter, generated additional sales of 1.8 TWh or $84 million compared with 2001. Growth was strongest in the residential and farm category, as heating requirements make it the most sensitive to climatic changes.

Investing Activities

In 2002, Hydro-Québec Distribution's capital expenditures (including intangibles) related to ongoing operations totaled $525 million. Of this amount, $206 million was used to maintain assets and $101 million to enhance system and customer service quality.

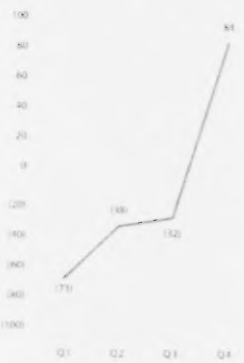
In addition, to keep pace with the growth in housing starts, the division invested close to $151 million to supply new customers.

Increase in Demand by Category from 2001 to 2002



Residential and farm
General and institutional
Industrial
Other

Cumulative Effect of Temperature Variations Between 2001 and 2002 on Sales Revenue
($M)



Transmission

Hydro-Québec TransÉnergie

TransÉnergie HQ inc. 100%

TransÉnergie U.S. Ltd. 100%

Cedars Rapids Transmission Company, Limited 100%

Transelec S.A. 100%
CHILE

Consorcio TransMantaro S.A. 56.66%
PERU

DirectLink (J.J.V.) 33.33%
AUSTRALIA

MurrayLink Transmission Co. Pty Ltd. 50%
AUSTRALIA

Division of Hydro-Québec ■

Subsidiary, joint venture or interest

International activities: activities and/or subsidiaries, joint ventures or interests through HQI

TRANSMISSION

In January 2003, the Régie de l'énergie rendered its final decision authorizing Hydro-Québec TransÉnergie to modify its electricity transmission rates retroactive to January 1, 2001. Net income for 2001 and 2002 has been restated accordingly (see note 20 to the financial statements).

Operating Results

In 2002, Hydro-Québec TransÉnergie managed the capacity of its transmission system profitably while respecting the environment and current regulations and meeting customer expectations of quality.

Net income stood at $389 million in 2002, down $105 million or 21.3% from the previous year. This decrease is primarily due to reduced sales, higher expenses related to telecommunications activities, and international activities.

Sales reached $3,027 million, down $59 million or 1.9% from 2001. Regulated activities account for most of this decrease. Long-term transmission sales by the division decreased by $49 million as a result of fewer customer reservations.

Total expenditure before financial expenses amounted to $1,576 million, compared with $1,453 million in 2001, up $123 million or 8.5%. This increase stems primarily from unregulated telecommunications activities and, in particular, the impact on depreciation and amortization expense of the downward revision of the service lives of certain facilities.

Financial expenses of the division declined by $77 million to $1,062 million. Debt and financial expenses are managed at the corporate level and subsequently allocated to the divisions. In the case of Hydro-Québec TransÉnergie, however, the decrease in financial expenses was partially offset by the increase in foreign exchange losses of $42 million related to the activities of Transelec and resulting from the devaluation of the Chilean peso.

Investing Activities

In 2002, Hydro-Québec TransÉnergie's capital expenditures (including intangibles) totaled $702 million, mainly in ongoing operations. Of this amount, $492 million relates to regulated activities, including $270 million which was used to ensure the long-term operability of the transmission grid. In particular, the division spent $37 million to advance work on Beauharnois generating station and $12 million to finish upgrading the System Control Centre (SCC).

In June 2002, the division received authorization from the Québec government to finish construction of the Hertel–Des Cantons line and to build Montérégie substation. It invested $53 million in the project, which will complete the region's 735-kV transmission loop. The new facilities are slated to come into commercial service during the winter of 2003–2004.

To connect the future Toulnustouc generating station, Hydro-Québec TransÉnergie spent $16 million in 2002 on continued construction of the 69-kV line and on work to supply the construction site's power needs. These activities were completed in May.

In addition, the division spent $161 million through its subsidiaries, mainly on fixed assets. TransÉnergie HQ's American subsidiary, TransÉnergie U.S., accounted for most of this amount, spending $102 million to complete the Cross Sound Cable project, which involves the construction of an underwater high-voltage direct-current interconnector. In addition, $52 million was spent on international activities through Hydro-Québec's interests in Chile, Peru and Australia.

Lastly, Consorcio TransMantaro, the company operating a transmission line in Peru, reduced its capital in 2002 and redistributed $3.6 million to Hydro-Québec International for its 56.66% interest in the consortium.

STRONG GROWTH IN DEMAND

The growth in revenues from Québec electricity sales largely reflects a 4.3-TWh or $230-million demand increase, fueled by the recovery of several Québec economic sectors in 2002.

Demand from industrial customers showed the strongest growth, with a 2.2-TWh increase in sales adding revenue of $98 million. This growth was mainly driven by the arrival of major new customers in the pulp and paper and metal smelting and refining industries in the third quarter of 2001. Also, the upswing in the manufacturing sector boosted demand from small- and medium-power industrial customers.

Rising employment and low interest rates, coupled with a high rental occupancy rate, spurred residential construction, which continued to be a driver of economic growth in Québec. These factors also bolstered household confidence and consumption. Demand in the residential/farm and general/institutional categories grew by 1.1 TWh and 0.9 TWh, or $67 million and $62 million, respectively.

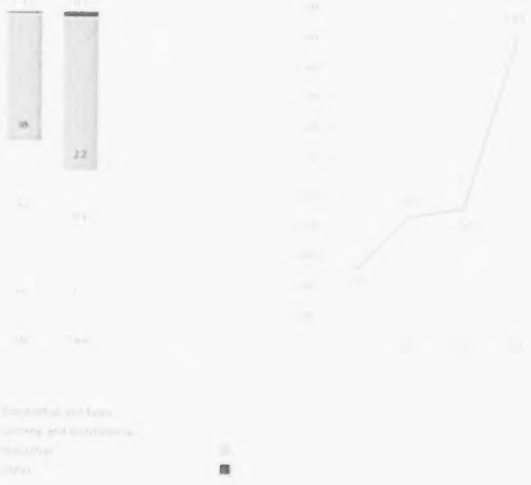
MORE SEASONAL TEMPERATURES

This year's colder temperatures, especially in the last quarter, generated additional sales of 1.8 TWh or $84 million compared with 2001. Growth was strongest in the residential and farm category, as heating requirements make it the most sensitive to climatic changes.

Investing Activities

In 2002, Hydro-Québec Distribution's capital expenditures (including intangibles) related to ongoing operations totaled $525 million. Of this amount, $206 million was used to maintain assets and $101 million to enhance system and customer service quality.

In addition, to keep pace with the growth in housing starts, the division invested close to $151 million to supply new customers.



TRANSMISSION

In January 2003, the Régie de l'énergie rendered its final decision authorizing Hydro-Québec TransÉnergie to modify its electricity transmission rates retroactive to January 1, 2001. Net income for 2001 and 2002 has been restated accordingly (see note 20 to the financial statements).

Operating Results

In 2002, Hydro-Québec TransÉnergie managed the capacity of its transmission system profitably while respecting the environment and current regulations and meeting customer expectations of quality.

Net income stood at $389 million in 2002, down $105 million or 21.3% from the previous year. This decrease is primarily due to reduced sales, higher expenses related to telecommunications activities, and international activities.

Sales reached $3,027 million, down $59 million or 1.9% from 2001. Regulated activities account for most of this decrease. Long-term transmission sales by the division decreased by $49 million as a result of fewer customer reservations.

Total expenditure before financial expenses amounted to $1,576 million, compared with $1,453 million in 2001, up $123 million or 8.5%. This increase stems primarily from unregulated telecommunications activities and, in particular, the impact on depreciation and amortization expense of the downward revision of the service lives of certain facilities.

Financial expenses of the division declined by $77 million to $1,062 million. Debt and financial expenses are managed at the corporate level and subsequently allocated to the divisions. In the case of Hydro-Québec TransÉnergie, however, the decrease in financial expenses was partially offset by the increase in foreign exchange losses of $42 million related to the activities of Transelec and resulting from the devaluation of the Chilean peso.

Investing Activities

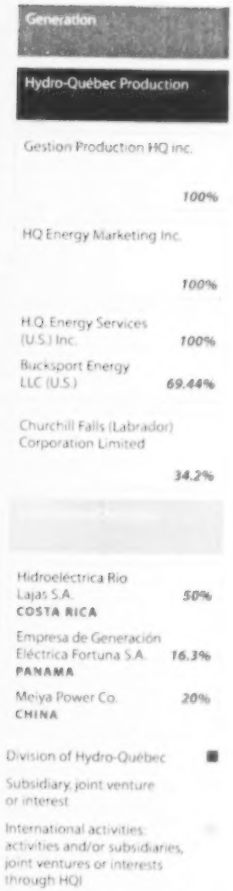
In 2002, Hydro-Québec TransÉnergie's capital expenditures (including intangibles) totaled $702 million, mainly in ongoing operations. Of this amount, $492 million relates to regulated activities, including $270 million which was used to ensure the long-term operability of the transmission grid. In particular, the division spent $37 million to advance work on Beauharnois generating station and $12 million to finish upgrading the System Control Centre (SCC).

In June 2002, the division received authorization from the Québec government to finish construction of the Hertel–Des Cantons line and to build Montérégie substation. It invested $53 million in the project, which will complete the region's 735 kV transmission loop. The new facilities are slated to come into commercial service during the winter of 2003–2004.

To connect the future Toulnustouc generating station, Hydro-Québec TransÉnergie spent $16 million in 2002 on continued construction of the 69-kV line and on work to supply the construction site's power needs. These activities were completed in May.

In addition, the division spent $161 million through its subsidiaries, mainly on fixed assets. TransÉnergie HQ's American subsidiary, TransÉnergie U.S., accounted for most of this amount, spending $102 million to complete the Cross Sound Cable project, which involves the construction of an underwater high-voltage direct-current interconnector. In addition, $52 million was spent on international activities through Hydro-Québec's interests in Chile, Peru and Australia.

Lastly, Consorcio TransMantaro, the company operating a transmission line in Peru, reduced its capital in 2002 and redistributed $3.6 million to Hydro-Québec International for its 56.66% interest in the consortium.



GENERATION

Operating Results

In addition to guaranteeing the supply of heritage pool electricity to the Québec market, Hydro-Québec Production, our generating division, is an active player on regional energy markets in the northeastern part of the continent. Its activities outside Québec are focused on selling surplus electricity generated in Québec, purchasing electricity for resale and conducting price arbitraging. In 2002, the division again took advantage of terms on the markets, which enabled it to attain record levels of sales and net income.

The segment's net income totaled $1.6 billion in 2002, an increase of $0.4 billion over 2001. This performance was principally driven by the higher volume of sales on all markets and the appreciable profitability of sales outside Québec. Sales grew by $0.6 billion to reach $7.9 billion.

ELECTRICITY SALES TO HYDRO-QUÉBEC DISTRIBUTION

Electricity sales to Hydro-Québec Distribution stood at 158.0 TWh or $4.2 billion, compared with 151.9 TWh or $4.1 billion in 2001. They accounted for 74% of the division's total sales and 54% of its revenue. In 2002, growth in this market exceeded forecasts.

Sales of heritage pool electricity to Hydro-Québec Distribution are conducted in accordance with the terms and conditions established by the Québec government in 2000, namely a rate of 2.79 cents per kilowatthour, subject to an adjustment to reflect certain contracts, for a maximum annual volume of 165 TWh. Over and above this volume, sales must be made under a bidding process at the terms prevailing in the market at the time.

ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec reached 54.2 TWh or $3.5 billion, up $0.4 billion from 2001. The net reservoir drawdown for sales outside Québec totaled 12.6 TWh in 2002, against 10.2 TWh in 2001. The remaining sales of 41.6 TWh in 2002 (32.2 TWh in 2001) reflect energy trading on U.S. markets and, since it opened up for competition on May 1, 2002, the Ontario market.

On international markets, activities carried out through Hydro-Québec's foreign interests, primarily in Panama, generated sales of $40 million, or $2 million more than in 2001.

ELECTRICITY AND FUEL PURCHASED

Electricity and fuel purchases amounted to $3.0 billion in 2002, a $0.3 billion increase over 2001. A total of $2.3 billion of electricity was purchased on U.S. short-term markets. The average price of these purchases fell in 2002, consistent with the general trend in electricity market prices.

Investing Activities

In 2002, Hydro-Québec Production's capital expenditures (including intangibles) totaled $1,033 million. Of this amount, $298 million was spent on work to ensure the long-term operability of existing facilities. This work focused on modernizing power stations, maintaining their performance and extending their useful lives. The division's key projects for 2002 were the ongoing refurbishment of Beauharnois, Rapides-des-Quinze, Bersimis-1 and Outardes-3 generating stations. Work also continued on the draft design project for refurbishing Gentilly-2 nuclear generating station.

In 2002, the division spent $735 million to provide additional capacity in Québec through the construction of new generating stations, specifically the new Grand-Mère hydroelectric development ($122 million) and Toulnustouc generating station ($167 million), which are ongoing, Eastmain-1 generating station ($86 million), and the Eastmain-1-A generating station and Rupert diversion draft design project ($40 million). It also continued work on Sainte-Marguerite-3 generating station ($287 million). Finally, activities to correct a problem of geological origin in the Sainte-Marguerite-3 headrace tunnel were completed at the end of 2002 and the facility is expected to be fully commissioned in 2003.

Construction

Hydro-Québec Équipement

Société d'énergie de la Baie James

100%

Division of Hydro-Québec ■

Subsidiary, joint venture or interest

CONSTRUCTION

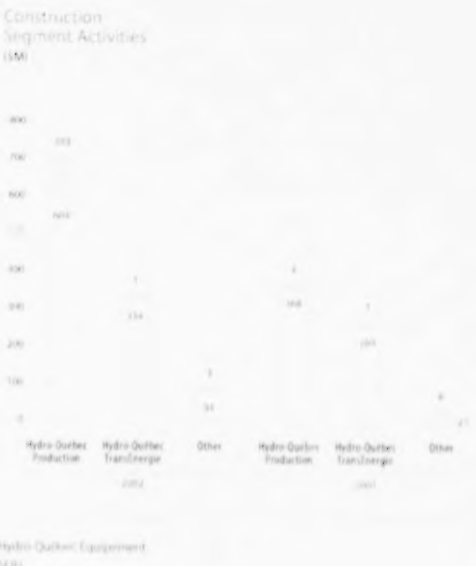
Hydro-Québec Équipement

Hydro-Québec Équipement completed $1 billion in orders during the year, up $300 million or 43% over 2001. This substantial growth was derived from numerous ongoing projects, primarily in the Transmission and Generation segments, and government approvals obtained for the construction of new facilities. All investments by the division relate to major generating station refurbishment, facility construction, transmission network reinforcement and hydroelectric capacity development.

Société d'énergie de la Baie James

Société d'énergie de la Baie James (SEBJ) carries out hydroelectric engineering and construction projects on behalf of Hydro-Québec in the territory governed by the *James Bay and Northern Québec Agreement*. SEBJ also uses its expertise as leverage to obtain project management or construction contracts in Québec and on external markets.

Its activities, mainly on behalf of Hydro-Québec Production, generated revenue of $107 million in 2002, compared with $9 million the preceding year. This strong growth followed the signing of agreements with the Cree communities to commence construction of the Eastmain-1 facilities and the draft design studies for Eastmain 1-A generating station and the Rupert diversion. SEBJ also conducted preliminary studies in 2002 to assess hydroelectric potential in Nunavik, and continued construction of the Les Cèdres–Cornwall transmission line for Cedars Rapids Transmission Company, a subsidiary of Hydro-Québec TransÉnergie.



Hydro-Québec Équipement
SEBJ

GENERATION

Operating Results

In addition to guaranteeing the supply of heritage pool electricity to the Québec market, Hydro-Québec Production, our generating division, is an active player on regional energy markets in the northeastern part of the continent. Its activities outside Québec are focused on selling surplus electricity generated in Québec, purchasing electricity for resale and conducting price arbitraging. In 2002, the division again took advantage of terms on the markets which enabled it to attain record levels of sales and net income.

The segment's net income totaled $1.6 billion in 2002, an increase of $0.4 billion over 2001. This performance was principally driven by the higher volume of sales on all markets and the appreciable profitability of sales outside Québec. Sales grew by $0.6 billion to reach $7.9 billion.

ELECTRICITY SALES TO HYDRO-QUÉBEC DISTRIBUTION

Electricity sales to Hydro-Québec Distribution stood at 158.0 TWh or $4.2 billion, compared with 151.9 TWh or $4.1 billion in 2001. They accounted for 74% of the division's total sales and 54% of its revenue in 2002, growth in this market exceeded forecasts.

Sales of heritage pool electricity to Hydro-Québec Distribution are conducted in accordance with the terms and conditions established by the Québec government. In 2000, namely a rate of 2.79 cents per kilowatthour, subject to an adjustment to reflect certain contracts, for a maximum annual volume of 165 TWh. Over and above this volume, sales must be made under a bidding process at the terms prevailing in the market at the time.

ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec reached 54.2 TWh or $3.3 billion, up $0.4 billion from 2001. The net reservoir drawdown for sales outside Québec totaled 12.6 TWh in 2002, against 10.2 TWh in 2001. The remaining sales of 41.6 TWh in 2002 (32.2 TWh in 2001) reflect energy trading on U.S. markets and, since it opened up for competition on May 1, 2002, the Ontario market.

On international markets, activities carried out through Hydro-Québec's foreign interests, primarily in Panama, generated sales of $40 million, or $2 million more than in 2001.

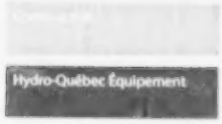
ELECTRICITY AND FUEL PURCHASED

Electricity and fuel purchases amounted to $3.0 billion in 2002, a $0.3 billion increase over 2001. A total of $2.3 billion of electricity was purchased on U.S. short-term markets. The average price of these purchases fell in 2002, consistent with the general trend in electricity market prices.

Investing Activities

In 2002, Hydro-Québec Production's capital expenditures (including intangibles) totaled $1,013 million. Of this amount, $298 million was spent on work to ensure the long-term operability of existing facilities. This work focused on modernizing power stations, maintaining their performance and extending their useful lives. The division's key projects for 2002 were the ongoing refurbishment of Beauharnois, Rapides-des-Quinze, Bersimis 1 and Outardes 3 generating stations. Work also continued on the draft design project for refurbishing Gentilly-2 nuclear generating station.

In 2002, the division spent $715 million to provide additional capacity in Québec through the construction of new generating stations, specifically the new Grand-Mère hydroelectric development ($122 million) and Toulnustouc generating station ($167 million), which are ongoing. Eastmain-1 generating station ($85 million) and the Eastmain-1-A generating station and Rupert diversion draft design project ($40 million). It also continued work on Sainte-Marguerite-3 generating station ($287 million). Finally, activities to correct a problem of geological origin in the Sainte-Marguerite-3 headrace tunnel were completed at the end of 2002 and the facility is expected to be fully commissioned in 2003.



CONSTRUCTION

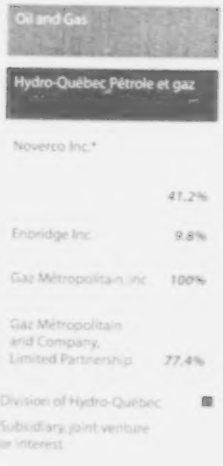
Hydro-Québec Équipement

Hydro-Québec Equipement completed $1 billion in orders during the year, up $300 million or 43% over 2001. This substantial growth was derived from numerous ongoing projects, primarily in the Transmission and Generation segments, and government approvals obtained for the construction of new facilities. All investments by the division relate to major generating station refurbishment, facility construction, transmission network reinforcement and hydroelectric capacity development.

Société d'énergie de la Baie James

Société d'énergie de la Baie James (SEBJ) carries out hydroelectric engineering and construction projects on behalf of Hydro-Québec in the territory governed by the *James Bay and Northern Québec Agreement*. SEBJ also uses its expertise as leverage to obtain project management or construction contracts in Québec and on external markets.

Its activities, mainly on behalf of Hydro-Québec Production, generated revenue of $107 million in 2002, compared with $9 million the preceding year. This strong growth followed the signing of agreements with the Cree communities to commence construction of the Eastmain-1 facilities and the draft design studies for Eastmain-1-A generating station and the Rupert diversion. SEBJ also conducted preliminary studies in 2002 to assess hydroelectric potential in Nunavik, and continued construction of the Les Cèdres–Cornwall transmission line for Cedars Rapids Transmission Company, a subsidiary of Hydro-Québec TransÉnergie.



OIL AND GAS

Operating Results

Hydro-Québec Pétrole et gaz encompasses Hydro-Québec's interest in Noverco and new operations to develop the oil and gas potential of eastern Québec. Since oil and gas exploration work only began at the end of 2002, the division's results mostly reflect the performance of Noverco.

INCREASED PROFITABILITY AT NOVERCO

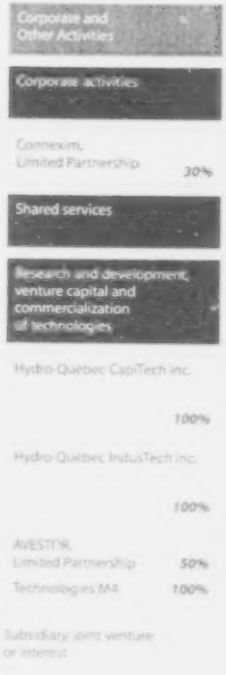
Net income of the division stood at $35 million, compared with $21 million in 2001. This growth is primarily attributable to the increased profitability of Hydro-Québec's interest in Noverco, which generated net income of $38 million, up $20 million over the preceding year. A $6-million dilution gain from the issuance of shares by Enbridge and Enbridge's improved operating results account for just over half of this growth. Another factor was the reduction in Noverco's financial expenses due to a drop in interest rates and the improved results of Gaz Métropolitain and Company, Limited Partnership (GMCLP).

Sales for the division totaled $849 million, down $217 million from 2001. This decrease is explained by the lower price on the markets for natural gas. However, in the current regulatory environment in Québec, natural gas purchased on the market by GMCLP is billed to customers at cost. As a result, fluctuations in natural gas prices do not have any direct effect on GMCLP's gross margin or its partners' income.

Investing Activities

Investments by Hydro-Québec Pétrole et gaz amounted to $75 million, of which $63 million relates to Hydro-Québec's share of the amounts invested by GMCLP and $12 million to Noverco's acquisition of new Enbridge shares. GMCLP's investing activities in 2002 essentially consisted in fixed asset acquisitions ($48 million) and deferred charges ($12 million). Total investments were down $56 million from the $131 million spent during the preceding year. GMCLP alone saw its investment level fall by $69 million compared with 2001.

* The Corporation holds investments in associates and subsidiaries in the oil and gas industry.


Corporate and Other Activities
Corporate activities
Connexim, Limited Partnership 30%
Shared services
Research and development, venture capital and commercialization of technologies
Hydro-Québec CapiTech inc. 100%
Hydro-Québec IndusTech inc. 100%
AVESTOR, Limited Partnership 50%
Technologies M4 100%
Subsidiary, joint venture or interest

CORPORATE AND OTHER ACTIVITIES

Operating Results

Corporate and Other Activities covers all corporate activities, shared procurement and information technology services, and research and development activities, which are complemented by capital venturing and the commercialization of Hydro-Québec technologies.

Operating results show a loss of $56 million, comparable to the $61-million loss reported in 2001. However, including the $513-million restatement required under the new foreign currency translation accounting standard, the 2001 results present a loss of $574 million. The loss for 2002 is mainly due to the venture capital activities of the subsidiary Hydro-Québec CapiTech and the technology commercialization activities of the subsidiary Hydro-Québec IndusTech.

CORPORATE ACTIVITIES

Corporate activities include finance, human resources, strategic planning and corporate affairs. The Finance department manages corporate debt and financial expenses and then allocates the financial expenses to the operating segments. The significant decrease in these expenses in 2002 improved the results of each segment.

SHARED SERVICES

The Shared Services Centre is in charge of all procurement and information technology services. The purpose of the centre is to support the client divisions and corporate units on a partnership basis by providing quality services at the lowest possible cost. In 2002, the activities of this centre totaled $551 million, on a par with the $541 million recorded in 2001.

RESEARCH AND DEVELOPMENT

R&D activity is focused on the company's core businesses, namely the generation, transmission and distribution of electricity. In 2002, R&D spending, principally by Hydro-Québec's research institute, totaled $103 million, the same level as in 2001. Most expenses are billed back to the client divisions. R&D helps enhance the efficiency and competitiveness of the divisions, be it through additional sales, reduced costs, productivity gains or prolonged asset service life.

VENTURE CAPITAL

Hydro-Québec CapiTech, which makes venture capital investments in energy-related technologies, posted a $29-million loss, $22 million more than in 2001. This weak performance is largely due to the sluggishness that continued to plague the stock markets. As a result, Hydro-Québec CapiTech had to write down the book value of its investment portfolio by $25 million or 17% in order to reflect in its income the permanent impairment of certain interests.

Hydro-Québec Pétrole et gaz

Noverco Inc.*

41.2%

Enbridge Inc. 9.8%

Gaz Métropolitain Inc. 100%

Gaz Métropolitain and Company Limited Partnership 77.3%

Division of Hydro-Québec

Subsidiary and interest in subsidiary

OIL AND GAS

Operating Results

Hydro-Québec Pétrole et gaz encompasses Hydro-Québec's interest in Noverco and new operations to develop the oil and gas potential of eastern Québec. Since oil and gas exploration work only began at the end of 2002, the division's results mainly reflect the performance of Noverco.

Increased Profitability of Noverco

Net income of the division stood at $35 million, compared with $31 million in 2001. This growth is primarily attributable to the increased profitability of Hydro-Québec's interest in Noverco, which generated net income of $38 million, up $20 million over the preceding year. A $6 million dilution gain from the issuance of shares by Enbridge and Enbridge's improved operating results account for just over half of this growth. Another factor was the reduction in Noverco's financial expenses due to a drop in interest rates and the improved results of Gaz Métropolitain and Company Limited Partnership (GMCLP).

Sales for the division totaled $949 million, down $217 million from 2001. This decrease is explained by the lower price on the markets for natural gas. However, in the current regulatory environment in Québec, natural gas purchased on the market by GMCLP is resold to customers at cost. As a result, fluctuations in natural gas prices do not have any direct effect on GMCLP's gross margin or its partners' income.

Investing Activities

Investments by Hydro-Québec Pétrole et gaz amounted to $75 million, of which $63 million relates to Hydro-Québec's share of the amounts invested by GMCLP and $12 million to Noverco's acquisition of new Enbridge shares. GMCLP's investing activities in 2002 essentially consisted in fixed asset acquisitions ($48 million) and deferred charges ($12 million). Total investments were down $56 million from the $131 million spent during the preceding year. GMCLP alone saw its investment level fall by $67 million compared with 2001.

Corporate activities

30%

Shared services

Research and development, venture capital and commercialization of technologies

100%

100%

50%

100%

CORPORATE AND OTHER ACTIVITIES

Operating Results

Corporate and Other Activities covers all corporate activities, shared procurement and information technology services, and research and development activities, which are complemented by capital venturing and the commercialization of Hydro-Québec technologies.

Operating results show a loss of $56 million, comparable to the $61 million loss reported in 2001. However, including the $514 million restatement required under the new foreign currency translation accounting standard, the 2001 results present a loss of $576 million. The loss for 2002 is mainly due to the venture capital activities of the subsidiary Hydro-Québec CapiTech and the technology commercialization activities of the subsidiary Hydro-Québec InduxTech.

Corporate Activities

Corporate activities include finance, human resources, strategic planning and corporate affairs. The Finance department manages corporate debt and financial expenses and then allocates the financial expenses to the operating segments. The significant decrease in these expenses in 2002 improved the results of each segment.

Shared Services

The Shared Services Centre was created to provide all procurement and information technology services. The purpose of the centre is to support the client divisions and corporate units on a partnership basis by providing quality services at the lowest possible cost. In 2002, the activities of this centre totaled $551 million, on a par with the $541 million recorded in 2001.

Research and Development

R&D activity is focused on the company's core businesses, namely the generation, transmission and distribution of electricity. In 2002, R&D spending, principally by Hydro-Québec's research institute, totaled $103 million, the same level as in 2001. Most expenses are billed back to the client divisions. R&D helps enhance the efficiency and longer lifespan of the division, for example, additional sales, reduced costs, productivity gains or prolonged asset service life.

Venture Capital

Hydro-Québec CapiTech, which makes venture capital investments in energy related technologies, posted a $29 million loss, $22 million more than in 2001. The weak performance is largely due to the sluggishness that continued to plague the stock markets as a result. Hydro-Québec CapiTech had to write down the book value of its investment portfolio by $25 million or 17% in order to reflect in its income the permanent impairment of certain interests.

COMMERCIALIZATION OF HYDRO-QUÉBEC TECHNOLOGIES

Hydro-Québec IndusTech owns 50% of the units of AVESTOR, the limited partnership that manufactures and markets lithium-metal-polymer (LMP) batteries. Hydro-Québec IndusTech reported a loss of $24 million, $4 million less than in 2001. This loss mainly reflects the costs incurred to develop the product, start up production lines and launch marketing operations. In September 2002, AVESTOR opened its first plant in Boucherville for the purpose of marketing LMP batteries for the telecommunications industry.

Investing Activities

Total investments amounted to $149 million, up $88 million from the $61 million invested in 2001. The acquisition of two airplanes for renewal of the corporate fleet accounted for the largest portion of this increase ($52 million). Among other major investments, $65 million went to capital ventures, through Hydro-Québec CapiTech, and to the commercialization of Hydro-Québec technologies, through Hydro-Québec IndusTech. Finally, $30 million was spent to develop and purchase computer equipment.

Risks and Outlook

Risk Management

Noteworthy in 2002 were the organizational adjustments made to increase the divisions' accountability for the identification, assessment and monitoring of the principal risks to which they are exposed. The Corporation is confident that these changes will enhance the mechanisms introduced in recent years for the purpose of providing a comprehensive and accurate risk picture.

Senior management now has a chart that shows the Corporation's principal quantifiable risks. The chart is used to systematically monitor the level of these risks over the course of the year, taking actual year-to-date results into account. There is also a key risk positioning report, updated regularly for the members of the Finance Committee.

The principal risks associated with the activities of the units and the Corporation are analyzed and monitored for all business and strategic planning processes.

Since integrated risk management is a relatively new area, Hydro-Québec is closely following developments. It actively participates in the activities of discussion groups supported by the Conference Board of Canada. These groups examine the development of risk management analysis tools and techniques and of general trends in the field.

Hydro-Québec is pursuing its partnership with research agencies such as the Centre interuniversitaire de recherche en analyse des organisations (CIRANO). This partnership seeks to develop tools better suited to the needs of organizations. To date, it has provided Hydro-Québec with new tools for identifying and assessing the risks inherent in specific activities.

In the same vein, a chair in integrated risk management and mathematical finance, sponsored by Hydro-Québec, was created this year at the Université de Montréal. Hydro-Québec expects its partnership with the university to last five years.

Outlook

In 2003, we will pursue our strategy of developing Hydro-Québec's value, with a focus on strengthening financial performance.

Although the economy will not be as robust as in 2002, its performance in 2003 should remain solid and continue to drive growth in Québec electricity sales. We intend to maintain an active presence on the North American energy markets while relying on a prudent management approach that takes into consideration developments in market deregulation.

Our investment program, which will top $3 billion in 2003, will be the largest in a decade and will be implemented across various areas of activity.

We expect to invest heavily in power generation. In addition to the work on the hydroelectric facilities on the Eastmain River and at the Grand-Mère site, we will move forward with the construction of Toulnustouc and Mercier generating stations and the rehabilitation of Beauharnois station. We will also commission Sainte-Marguerite-3 generating station, commission some of the new equipment at Outardes-3, and complete the partial diversion of the Manouane River. Convinced of the potential of wind power, we will actively participate in its development, in particular by requesting proposals to set up facilities in Québec for the manufacture and assembly of wind turbines and components.

Improving service quality, as well as transmission and distribution network reliability and security, will continue to be a major focus of attention and investment. With this in mind, we will continue to reinforce the Montérégie high-voltage transmission system and step up our program to underground, automate and strengthen our distribution system. Lastly, we will move forward with the Customer Information System project, which will involve modernizing the computer systems and reengineering the business processes related to sales and customer service.

Energy efficiency remains a top concern that affects all of Hydro-Québec's marketing activities—commercial and technological research, communications, sales programs and consulting services. In keeping with the *Strategic Plan 2002–2006*, and subject to the approval of the Régie de l'énergie, we intend to begin, in the first six months of 2003, the development work needed to implement our comprehensive Energy Efficiency Plan.

In November 2002, Hydro-Québec presented the broad outline of its Québec Oil and Gas Exploration Plan 2002–2010. This plan contains a course of action that will enable the Corporation to play a leading role in oil and gas exploration in Québec.

Hydro-Québec intends to enhance the value of its holdings and foreign investments. In particular, we will continue to invest in our interest in AVESTOR, which, in September 2002, opened the Alpha plant in Boucherville. The first of its kind in the world, this plant will manufacture a lithium-metal-polymer battery, a highly efficient product whose technological and environmental applications will leave their mark in the years ahead.

Finally, in 2003, we will update our development strategies by drafting our *Strategic Plan 2004–2008*.

Forward-Looking Statements

This Management's Discussion and Analysis, and specifically the Outlook section, contains forward-looking statements based on the company's estimates and assumptions concerning its future results and the course of events. Because of the risks and uncertainties inherent in any forward-looking statements, the actual future results of Hydro-Québec could differ materially from those anticipated.

Management Report

Hydro-Québec's consolidated financial statements and all additional information contained in the Annual Report are the responsibility of Management and are approved by the Board of Directors. Management's responsibility also includes the selection of appropriate accounting practices in accordance with Canadian generally accepted accounting principles, as described in note 1. As required, Management makes informed judgments and prepares the most appropriate estimates of the outcome of events and transactions, with due consideration given to materiality. Financial information contained elsewhere in the Annual Report is consistent with that in the financial statements.

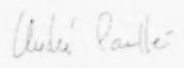
Management, in keeping with its responsibilities, maintains a control system designed, among other things, to provide reasonable assurance that the assets of Hydro-Québec are adequately recorded and safeguarded and that the accounting records form an appropriate basis for the preparation of reliable financial statements. An internal auditing process allows evaluation of the sufficiency and efficiency of control, as well as of Hydro-Québec's policies and procedures. Recommendations ensuing from this process are submitted to Management and the Audit Committee.

The Board of Directors assumes its responsibility for the consolidated financial statements principally through its Audit Committee, composed solely of directors who do not hold full-time positions within the Corporation or in one of its subsidiaries. This committee's mandate is to ensure that the financial statements present fairly Hydro-Québec's financial position, the results of its operations and its cash flows. The Audit Committee meets regularly with Management, the General Auditor and the external auditors to review the results of their audits and the reports on Hydro-Québec's accounting methods and policies and on the control systems. The General Auditor and the external auditors have full and unrestricted access to the Audit Committee, with or without Management's presence.

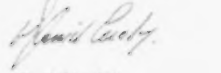
Hydro-Québec has also established a code of ethics and a code of conduct primarily to ensure the proper management of its resources and the orderly conduct of its business.

The consolidated financial statements have been audited jointly by accounting firms Samson Bélair/Deloitte & Touche and PricewaterhouseCoopers LLP.

Jacques Laurent
Chairman of the Board
of Directors



André Caillé
President and
Chief Executive Officer



Daniel Leclair
Vice President – Finance
and Chief Financial Officer

Montréal, Québec
February 20, 2003

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheet of Hydro-Québec as at December 31, 2002, and the consolidated statements of operations, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of Hydro-Québec's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Hydro-Québec as at December 31, 2002, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles as described in note 1. As required by the *Auditor General Act* (R.S.Q., c. V-5.01), we report that, in our opinion, after giving retroactive effect to the change in the accounting policy on foreign currency translation and except for the prospective application of the recommendations concerning goodwill and other intangible assets as explained in note 2, these principles have been applied on a basis consistent with that of the preceding year.

Samson Bélair
Deloitte & Touche

Chartered Accountants

PricewaterhouseCoopers LLP

Chartered Accountants

Montréal, Québec
February 20, 2003

Consolidated Statement of Operations

For the year ended December 31 ($M)	Notes	2002	2001 (restated - note 2)
REVENUE		**13,002**	12,578
EXPENDITURE			
Operations		**2,225**	2,134
Electricity and fuel purchased		**3,536**	3,532
Depreciation, amortization and decommissioning	3	**2,062**	1,845
Taxes	4	**580**	591
		8,403	8,102
OPERATING INCOME		**4,599**	4,476
Financial expenses	5	**3,043**	3,863
Income before non-controlling interest		**1,556**	613
Non-controlling interest		**30**	18
NET INCOME		**1,526**	595

Consolidated Statement of Retained Earnings

For the year ended December 31 ($M)	Notes	2002	2001 (restated - note 2)
Balance at beginning of year, as previously reported		**10,460**	9,906
Adjustment for the retroactive application of changes in accounting policies and other changes	2	**(1,326)**	(813)
Balance at beginning of year, as restated		**9,134**	9,093
Net income		**1,526**	595
		10,660	9,688
Dividends	16	**763**	554
Balance at end of year		**9,897**	9,134

Consolidated Balance Sheet

As at December 31 (Mc)	Notes	2002	2001 (restated - note 2)
ASSETS			
FIXED ASSETS	6	49,694	49,309
CURRENT ASSETS			
Cash and cash equivalents		293	251
Investments		939	617
Accounts receivable		1,924	1,766
Financial assets related to debt		34	106
Materials, fuel and supplies		418	427
		3,608	3,167
OTHER LONG-TERM ASSETS			
Investments	7	852	841
Deferred charges	8	3,391	3,808
Financial assets related to debt	9	325	299
Goodwill		302	306
Intangible assets	10	760	751
Government reimbursement for the 1998 ice storm		146	182
		5,776	6,187
		59,078	58,663
LIABILITIES AND EQUITY			
LONG-TERM DEBT	11	36,699	37,269
CURRENT LIABILITIES			
Borrowings		64	88
Dividends payable		763	554
Accounts payable		1,467	1,317
Accrued interest		1,157	1,201
Current portion of long-term debt		2,969	3,087
		6,420	6,247
OTHER LONG-TERM LIABILITIES	12	888	755
PERPETUAL DEBT	13	632	637
NON-CONTROLLING INTEREST		224	216
SHAREHOLDER'S EQUITY	14		
Share capital		4,374	4,374
Retained earnings		9,897	9,134
Translation adjustment		(56)	31
		14,215	13,539
		59,078	58,663

Yvon Lamontagne
Chairman of the Audit Committee

Jacques Laurent
Chairman of the Board of Directors

Consolidated Statement of Cash Flows

For the year ended December 31 ($M)	Note	2002	2001 (restated - Note 2)
OPERATING ACTIVITIES			
Net income		1,526	595
Depreciation and amortization of fixed assets and intangible assets		1,796	1,705
Amortization of deferred charges		320	1,100
Change in non-cash working capital items	11	(31)	50
Other		201	13
		3,812	3,463
INVESTING ACTIVITIES			
Fixed assets and intangible assets		(2,456)	(1,810)
Long-term investments		(40)	21
Net change in short-term investments		(318)	(46)
Other		47	(89)
		(2,767)	(1,924)
FINANCING ACTIVITIES			
Issue of long-term debt		2,098	4,544
Maturity of long-term debt and sinking fund redemption		(2,102)	(3,471)
Repayment in advance of long-term debt		(462)	(289)
Receipts resulting from credit risk management		51	25
Net change in short-term borrowings		(30)	(1,827)
Dividends paid		(554)	(539)
Other		(4)	157
		(1,003)	(1,400)
NET CHANGE IN CASH AND CASH EQUIVALENTS		42	139
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		251	112
CASH AND CASH EQUIVALENTS AT END OF YEAR		293	251
SUPPLEMENTARY INFORMATION			
Interest paid		2,696	3,018

Note 1
Significant Accounting Policies

Under the provisions of *Hydro-Québec Act*, the publicly owned corporation Hydro-Québec (the "Corporation") is mandated to supply power and to pursue endeavors in energy related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy.

The consolidated financial statements include the accounts of the Corporation, its subsidiaries, all of which are wholly owned, and its joint ventures (collectively "Hydro-Québec").

Regulation

The *Act respecting the Régie de l'énergie* grants the Régie de l'énergie exclusive authority to determine or modify the rates and conditions under which electricity is transmitted and distributed by the Corporation. Consequently, electricity transmission and distribution activities in Québec are said to be regulated.

In April 2002, the Régie de l'énergie rendered a decision on the application to amend electricity transmission rates. In its decision, the Régie de l'énergie recognized the current accounting policies used and accepted the changes requested, including the capitalization of financial expenses to fixed assets in progress at the cost of capital rate.

In July 2002, the Corporation filed an application with the Régie de l'énergie for approval of the cost of power distribution services as well as certain regulatory and accounting principles.

The joint venture Noverco Inc. wholly owns Gaz Métropolitain, Inc., whose main subsidiary, Gaz Métropolitain and Company, Limited Partnership, is involved primarily in the distribution of natural gas by pipeline in Québec. Most aspects of the limited partnership's operations are monitored and controlled by the Régie de l'énergie.

The consolidated financial statements take into account certain regulatory accounting practices which differ from the accounting practices applied in unregulated enterprises, and which relate specifically to certain deferred charges and the depreciation of fixed assets that are disposed of.

Consolidation

The interests in joint ventures are accounted for using the proportionate consolidation method. Investments in companies over which Hydro-Québec can exercise a significant influence are accounted for on an equity basis, whereas venture capital investments are generally recorded at cost. Other long-term investments are also recorded at cost.

The operations and cash flows of Noverco Inc. and of Hydro-Québec International (HQI) holdings are consolidated with a one-quarter lag. The financial positions of these companies disclosed in the consolidated balance sheet of Hydro-Québec are as at September 30.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires Management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual amounts could differ from those estimates.

Revenue

Revenue is recognized when electricity is delivered or services are rendered. Revenue from sales of electricity in Québec is recorded on the basis of cyclical billings and also includes revenue accrued in respect of electricity delivered but as yet unbilled.

Income taxes

The Corporation and certain of its incorporated subsidiaries have not recorded any income taxes since they are government-owned and therefore tax-exempt.

The incorporated second-tier subsidiaries and joint ventures subject to income tax use the liability method to account for income taxes.

Foreign currency translation

Revenue and expenditure resulting from transactions in foreign currencies are translated into the Canadian dollar equivalent at exchange rates in effect at the transaction date. Monetary assets and liabilities are translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, and non-monetary items are translated into Canadian dollars at exchange rates in effect at the transaction date.

The exchange gains or losses resulting from the translation of current monetary items are included in the consolidated statement of operations. Since January 1, 2002, those resulting from the translation of long-term monetary items are also included in the statement of operations, unless they relate to liabilities hedging sales in U.S. dollars, in which case they are deferred to the year such sales are made.

Currency swaps used to manage exchange risk related to principal payments on long-term debt and sales in U.S. dollars are translated at the closing exchange rates in effect at the balance sheet date. Those that constitute financial assets are presented as Financial assets related to debt, while those representing financial liabilities are presented as Long-term debt. Gains or losses on currency swaps related to principal payments on long-term debt are included in the statement of operations, while gains or losses on currency swaps related to sales in U.S. dollars are deferred to the end of the swap contract, that is, the year the sales are made.

Hydro-Québec uses the temporal method for translating the financial statements of foreign operations considered to be integrated in terms of financial and operational management. The financial statements of the main foreign operations considered to be self-sustaining in terms of financial and operational management are translated on a current rate basis using the foreign currency as the measuring unit. Exchange gains or losses are presented as a translation adjustment under Shareholder's equity.

Fixed assets

Fixed assets are carried at cost, which comprises materials, labor, other costs directly contributing to construction activities and borrowing costs capitalized during construction.

The costs of fixed assets in progress are transferred to fixed assets in service when construction is completed and the facilities are in commercial operation. As for generating facilities, the costs are transferred in installments as generating units of the facilities are completed and commissioned.

Fixed assets are depreciated over their useful lives, primarily under the sinking fund method, at a rate of 3%. Under the *Hydro-Québec Act*, the depreciation period is restricted to a maximum of 50 years. The depreciation periods for the main classes of fixed assets are as follows:

Distribution substations and lines	25 to 40 years
Transmission substations and lines	30 to 50 years
Hydraulic generation	45 to 50 years
Thermal generation, including nuclear	15 to 30 years

Financial expenses capitalized to fixed assets in progress are determined using the average cost of long-term debt of the Corporation at the end of the previous year. Financial expenses capitalized to fixed assets in progress to be used in regulated transmission activities take a return on shareholder's equity into account. The portion that corresponds to the return on shareholder's equity is included in Revenue in the statement of operations.

Note 1
Significant Accounting Policies (continued)

As of January 1, 2002, when non-regulated fixed assets are disposed of, the cost of such assets and the cost of their dismantlement, net of accumulated depreciation and salvage value, are charged to operations for the year. Upon disposal of regulated fixed assets, these costs are charged to a separate account and amortized over a maximum period of 10 years, under the sinking fund method, at a rate of 3%.

Cash and cash equivalents and short-term investments

Cash and cash equivalents comprise cash and liquid short-term investments with a maturity of three months or less from the date of acquisition. Investments with a maturity of three to twelve months are disclosed separately under Current assets in the balance sheet.

Short-term investments are shown at amortized cost. The book value of the investments approximates their fair value.

Employee future benefits

The Corporation offers all its employees a contributory defined benefit pension plan, based on final pay, as well as other post-retirement and post-employment benefits.

The cost of pension benefits and other post-retirement benefits provided in exchange for services rendered during the year is calculated using the projected benefit method prorated on years of service, and is based on best estimate economic and demographic assumptions as determined by Management.

In order to establish its employee future benefit obligations, the Corporation has adopted the following policies:

Past service costs arising from plan amendments and transitional balances relating to the Pension Plan and other post-retirement benefits as at January 1, 1999, are amortized on a straight-line basis over the employees' expected average remaining service life. The transitional obligation relating to post-employment benefits is amortized on a straight-line basis over a period of five years.

Amortization of actuarial gains or losses is recognized in the expense for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the accrued benefit obligation or 10% of the market-related value of the assets of the plan fund, whichever is greater. Amortization corresponds to the excess divided by employees' expected average remaining service life.

The expected return on Pension Plan assets is based on a market-related value determined by using a five-year moving average for equity securities held, and by valuing other asset classes at their fair value.

The value of the contribution holiday granted to employees for the year is disclosed as a reduction of service cost, as contributions deemed paid and amortized using the method for amortizing actuarial gains and losses.

Goodwill and intangible assets

The excess of the cost of the investments in the subsidiaries and joint ventures over the share of the fair value of the net assets acquired is recorded as goodwill. Effective January 1, 2002, goodwill and intangible assets with indefinite useful lives are no longer amortized. These assets are tested for impairment, annually or more frequently, if events indicate a potential impairment in value. The excess of the carrying value over the fair value is recorded in the year in which the impairment is determined. Intangible assets with definite useful lives are amortized over those estimated useful lives. Intangible assets are amortized according to the following methods and periods:

Software, licenses and patents	straight-line	3 to 15 years
Rights	sinking fund at 3%	40 years
Environmental studies	sinking fund at 3%	5 years

Sinking funds

Sinking funds are created through the purchase of the Corporation's debentures, Government of Canada bonds, or bonds issued or guaranteed by the Québec government. The Corporation's debentures are deducted from long-term debt, while the other securities are presented as Financial assets related to debt.

Sinking fund securities are carried at unamortized cost, a method whereby the difference between the cost and the par value at maturity is amortized over the remaining term of the security.

Derivative instruments

Hydro-Québec uses various derivative instruments to manage foreign exchange and interest rate risk associated with long-term debt, foreign exchange risk related to sales and the risk related to fluctuating energy and raw material prices.

According to corporate policy, in order for a derivative instrument to qualify for hedge accounting, Hydro-Québec must be reasonably certain that the risk will materialize and that the hedge will be effective throughout the hedging period.

When the conditions for applying hedge accounting are not satisfied or hedging is discontinued, derivative instruments are valued at market value. Derivative instruments used for trading purposes, such as forward contracts, options and swaps, as well as open positions on energy trading, are also valued at market value. Realized and unrealized changes in fair value are recognized in income as they occur.

The fair value of derivative instruments is based on the spot rates or forward rates or prices in effect at market closing at the balance sheet date. In the absence of this information for a given instrument, Management uses the available forward rate or price for an equivalent instrument. Different valuation models recognized by financial markets are used to estimate the fair value of options.

Interest rate exchanges, all of which are accounted for as hedges and which arise from currency swap agreements used to change long-term exposure to interest rate risk, are matched to interest expense on the borrowings to which they are related. The corresponding amounts payable or receivable are recorded as adjustments to accrued interest.

Derivative instruments used in the short term to manage financial risk over a period of no more than three years are, under hedge accounting, recorded at cost. Realized gains or losses related to these instruments are deferred and charged to operations on a basis consistent with the recognition of the gains or losses of the underlying reverse risk position.

Note 1
Significant Accounting Policies (continued)

When employed for hedging purposes, derivative instruments used to manage risks related to energy price fluctuations are accounted for at cost and the related gains or losses are deferred and charged to operations on a basis consistent with the recognition of the gains and losses of the underlying reverse risk position.

Decommissioning of nuclear generating station

The future costs of decommissioning Gentilly-2 nuclear generating station are charged progressively to operations and reflected in Other long-term liabilities. These estimated costs essentially relate to the cost of dismantling the station and removal of the irradiated fuel, increased by the interest capitalized annually to the accrued amounts. Interest is calculated at the expected nominal rate on Hydro-Québec's long-term borrowings. Future decommissioning costs are charged to operations annually under a sinking fund method over the remaining useful life of the plant.

The Corporation revises these costs periodically based on the various assumptions and estimates underlying the calculations, possible technological advances and changes in the standards and regulations governing the decommissioning of nuclear generating stations. The restatements resulting from these revisions are accounted for on a prospective basis.

Reclassification

Some figures of the previous year have been reclassified in order to respect the presentation adopted in the current year.

Note 2
Changes in Accounting Policies

Foreign currency translation

The Canadian Institute of Chartered Accountants (CICA) has revised Section 1650 of the *CICA Handbook*, entitled "Foreign Currency Translation," effective January 1, 2002. All unrealized exchange gains and losses related to monetary items denominated in foreign currencies must henceforth be charged to income for the year, including gains and losses on long-term monetary assets and liabilities, which were formerly deferred and amortized on a straight-line basis over the remaining term of the corresponding asset or liability. To reduce volatility resulting from the elimination of the deferral and amortization of unrealized gains and losses, the Corporation adapted its foreign exchange risk management strategy in 2002. In accordance with the new standard, Hydro-Québec has applied these changes retroactively and the prior year's comparative figures have been restated.

Goodwill and other intangible assets

On January 1, 2002, Hydro-Québec also adopted the recommendations of Section 3062 of the *CICA Handbook*, entitled "Goodwill and Other Intangible Assets." Thus, goodwill and intangible assets with indefinite useful lives are henceforth no longer amortized and are subject to an impairment test.

The Corporation conducted the impairment tests required by the new standard and concluded that no impairment charges were necessary.

Transitional information

The following table presents the effects of applying the new accounting standards:

	2002	2001
Net income reported	**1,526**	1,108
Restatements	**–**	513
Restated net income	**1,526**	595
Amortization of goodwill and intangible assets with indefinite useful lives	**–**	21
Adjusted net income	**1,526**	616

As at January 1, 2002, the retroactive application of the new recommendations had the principal effect of reducing deferred charges by $1,197 million and increasing perpetual debt by $85 million.

Note 3
Depreciation, Amortization and Decommissioning

	2002	2001
Depreciation of fixed assets	**1,670**	1,617
Amortization of intangible assets	**126**	88
Decommissioning of nuclear generating station	**77**	13
Write-off of projects	**105**	1
Other	**84**	126
	2,062	1,845

Note 4
Taxes

	2002	2001
Capital tax	**281**	284
Tax on gross revenue as municipal real estate tax on certain immovables	**229**	228
Municipal, school and other taxes	**70**	79
	580	591

Note 5
Financial Expenses

	2002	2001 (restated – note 2)
INTEREST		
Interest on debt securities	**2,921**	3,105
Amortization of borrowing discount and expenses	**45**	53
	2,966	3,158
EXCHANGE LOSS	**234**	819
LOAN GUARANTEE FEES	**188**	185
	422	1,004
Less		
Capitalized borrowing costs	**318**	248
Net investment income	**27**	51
	345	299
	3,043	3,863

Note 6
Fixed Assets

	In service	Accumulated depreciation	In progress	2002 Total
DISTRIBUTION				
Substations and lines	9,636	2,912	214	**6,938**
Other	1,982	1,073	92	**1,001**
	11,618	3,985	306	**7,939**
TRANSMISSION				
Substations and lines	19,306	4,653	1,145	**15,798**
Other	2,234	1,207	110	**1,137**
	21,540	5,860	1,255	**16,935**
GENERATION				
Hydraulic	24,145	5,877	3,484	**21,752**
Thermal, including nuclear	2,429	1,253	41	**1,217**
Other	839	311	61	**589**
	27,413	7,441	3,586	**23,558**
CONSTRUCTION	62	45	7	**24**
OIL AND GAS	1,323	442	7	**888**
OTHER	800	517	67	**350**
	62,756	18,290	5,228	**49,694**

	In service	Accumulated depreciation	In progress	2001 Total
DISTRIBUTION				
Substations and lines	9,267	2,622	201	6,846
Other	2,018	1,073	79	1,024
	11,285	3,695	280	7,870
TRANSMISSION				
Substations and lines	19,174	4,292	785	15,667
Other	2,137	1,040	213	1,310
	21,311	5,332	998	16,977
GENERATION				
Hydraulic	23,891	5,435	2,885	21,341
Thermal, including nuclear	2,409	1,152	22	1,279
Other	848	278	92	662
	27,148	6,865	2,999	23,282
CONSTRUCTION	55	42	6	19
OIL AND GAS	1,285	406	3	882
OTHER	722	485	42	279
	61,806	16,825	4,328	49,309

As at December 31, 2002, the Corporation had cumulative costs related to suspended draft design projects amounting to $336 million ($514 million as at December 31, 2001) for which financial expenses are not capitalized. These suspended draft design projects are recorded under Fixed assets in progress.

As certain projects have longer completion timelines, their cumulative costs are periodically reviewed.

During such reviews, Management must use estimates and make assumptions that have an impact on the amounts reported for draft design projects at the balance sheet date. Such projects are assessed in terms of profitability based on prevailing market conditions at the time of their commissioning, compliance with sustainable development principles and how well they are received by local communities. A significant change in the assessment based on these criteria could result in a reduction of the balance for draft design projects.

When a major project related to regulated fixed assets is discontinued, the costs determined to be non-recoverable are deferred over a period of three years using the straight-line method.

Note 7
Investments

	notes	2002	2001
AT COST			
Noverco Inc.	15		
Notes [a]		**141**	141
Churchill Falls (Labrador) Corporation Limited	19		
Bonds [b]		**57**	58
Other [c]		**230**	269
		428	468
AT EQUITY			
Enbridge Inc.		**244**	211
Churchill Falls (Labrador) Corporation Limited	19	**45**	39
Connexim, Limited Partnership		**35**	32
Meiya Power Company Limited		**98**	91
Other		**2**	–
		424	373
		852	841

a) Subordinate debentures, interest rate based on the annual average rate of Government of Canada bonds with terms of over 10 years plus 4.45%, due in 2031, redeemable.

b) Bonds secured by a general mortgage, 7.50%, due in 2010 (par value of $63 million in 2002 and $64 million in 2001).

c) Includes venture capital investments at a cost of $122 million and with a fair value of $117 million as at December 31, 2002 ($118 million and $118 million as at December 31, 2001). The fair value of listed shares is based on the trading price at the balance sheet date; the fair value of unlisted shares is cost.

Note 8
Deferred Charges

	note	2002	2001 (restated – note 2)
Deferred charges related to debt [a]		**2,335**	2,776
Employee future benefit asset	18	**752**	635
Other		**304**	397
		3,391	3,808

a) Mainly comprises a deferred exchange loss of $2,290 million ($2,640 million as at December 31, 2001).

Note 9
Financial Assets Related to Debt

	2002	2001
Currency swaps and contracts	**291**	316
Sinking funds	**68**	89
	359	405
Less		
Current portion	**34**	106
	325	299

Note 10
Intangible Assets

	2002			2001		
	Cost	Accumulated amortization	Total	Cost	Accumulated amortization	Total
SUBJECT TO AMORTIZATION						
Software and licenses	560	279	**281**	496	238	258
Rights	109	29	**80**	136	54	82
Environmental studies	112	95	**17**	95	64	31
Patents	36	9	**27**	33	4	29
	817	412	**405**	760	360	400
NOT SUBJECT TO AMORTIZATION						
Servitudes	496	141	**355**	493	142	351
	496	141	**355**	493	142	351
	1,313	553	**760**	1,253	502	751

Note 11
Long-Term Debt

Composition and maturities

Debentures, other long-term debt and currency swaps representing financial liabilities, translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, are summarized in the following table. These amounts are presented by year of maturity, and take into account the requirements of the sinking funds.

						2002	2001
	Debt of the Corporation						
Year of maturity	Canadian dollars	U.S. dollars	Other currencies	Total	Subsidiaries and joint ventures	Total	Total
2002							3,087
2003	970	1,501	290	2,761	208	**2,969**	3,305
2004	1,586	26	56	1,668	66	**1,734**	1,599
2005	1,531	646	172	2,349	353	**2,702**	2,528
2006	1,051	1,749	422	3,222	29	**3,251**	2,629
2007	683	641	27	1,351	270	**1,621**	–
1 to 5 years	5,821	4,563	967	11,351	926	**12,277**	13,148
6 to 10 years	3,906	1,840	1,340	7,086	1,061	**8,147**	7,115
11 to 15 years	16	2,189	632	2,837	124	**2,961**	4,358
16 to 20 years	4,657	3,167	–	7,824	65	**7,889**	4,766
21 to 25 years	8	1,422	–	1,430	62	**1,492**	4,563
26 to 30 years	1,084	2,843	–	3,927	96	**4,023**	4,517
31 to 35 years	2,146	–	–	2,146	–	**2,146**	1,183
36 to 40 years	280	–	–	280	–	**280**	276
41 to 45 years	–	–	–	–	–	**–**	2
46 to 50 years	50	–	–	50	–	**50**	50
51 to 55 years	–	–	–	–	–	**–**	–
56 to 60 years	403	–	–	403	–	**403**	378
	18,371[a]	16,024	2,939	37,334[b]	2,334	**39,668**	40,356
Less							
Current portion	970	1,501	290	2,761	208	**2,969**	3,087
	17,401	14,523	2,649	34,573	2,126	**36,699**	37,269

a) Includes $125 million and $277 million in zero-coupon bonds, reported at their discounted value at a semiannually compounded interest rate of 10.95% and 10.67% respectively. Their par value will reach $282 million and $1,729 million in 2010 and 2020 respectively. A specific sinking fund was created for this debt and totaled $81 million as at December 31, 2002. Other bonds, reported at their discounted value and amounting to $1,126 million, will reach a par value of $1,333 million on maturity.

b) Includes $36,596 million in bonds guaranteed by the Québec government ($36,835 million as at December 31, 2001).

Note 11
Long-Term Debt
(continued)

Allocation of debt by currency at time of issue and impact of financial assets related to debt

The following table summarizes long-term debt, including the current portion, in Canadian dollars and currency units. Also shown are the effects of currency swaps and sinking funds allocated to repay debt, which are presented on the balance sheet under Financial assets related to debt.

		Long-term debt	Financial assets related to debt	2002	2001
	In Canadian dollars and currency units	At the closing exchange rates at the balance sheet date[a]	Currency swaps and sinking funds	Total	Total
DEBT OF THE CORPORATION					
Canadian dollars	18,371	18,371	(67)	**18,304**	16,982
U.S. dollars	10,007	16,024	(85)	**15,939**	17,530
Other currencies					
Euros	727	1,322	(62)	**1,260**	1,516
Yen	46,500	704	(67)	**637**	794
Pounds sterling	300	802	(39)	**763**	766
Swiss francs	97	111	(15)	**96**	96
		2,939	(183)	**2,756**	3,172
		37,334	(335)	**36,999**	37,684
SUBSIDIARIES AND JOINT VENTURES[b]		2,334	(24)	**2,310**	2,267
		39,668	(359)	**39,309**	39,951

a) Includes $474 million of financial liabilities composed of currency swaps ($945 million as at December 31, 2001) and $561 million of Hydro-Québec securities held in the sinking funds ($452 million as at December 31, 2001).

b) Includes $818 million in Canadian dollars, $1,167 million in U.S. dollars, $321 million in Unidades de Fomento (indexed Chilean pesos) and $4 million in Chinese renminbi ($835 million in Canadian dollars, $1,092 million in U.S. dollars, $336 million in Unidades de Fomento and $4 million in Chinese renminbi as at December 31, 2001).

Allocation of debt by currency at time of issue and at time of repayment

The following table shows the allocation of debt, net of sinking funds, converted into Canadian dollars after taking swaps into account, according to the currency at time of issue and the currency at time of repayment.

	2002		2001	
	At time of issue	At time of repayment	At time of issue	At time of repayment
DEBT OF THE CORPORATION				
Canadian dollars	**18,304**	**17,778**	16,982	17,371
U.S. dollars	**15,939**	**19,221**[a]	17,530	20,313[a]
Other currencies	**2,756**	**–**	3,172	–
	36,999	**36,999**	37,684	37,684
DEBT OF THE SUBSIDIARIES AND JOINT VENTURES				
Canadian dollars	**818**	**818**	835	835
U.S. dollars	**1,167**	**920**	1,092	937
Other currencies	**325**	**572**	340	495
	2,310	**2,310**	2,267	2,267
	39,309	**39,309**	39,951	39,951

a) One hundred percent of the balances as at December 31, 2002 (83% in 2001) hedging sales in U.S. dollars.

Interest rates

The Hydro-Québec interest rates presented in the following table take into account nominal interest rates on borrowings, the related discounts and expenses, and the effect of interest rate swaps.

				2002	2001
Year of maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	2.76	7.16	4.84	**4.65**	4.87
6 to 10 years	8.29	5.45	5.69	**6.98**	5.56
11 to 15 years	10.25	7.17	9.21	**7.70**	9.29
16 to 20 years	10.61	9.17	6.20	**9.97**	10.50
21 to 25 years	8.80	8.56	–	**8.57**	9.16
26 to 30 years	6.68	9.21	–	**8.44**	8.46
31 to 35 years	6.26	–	–	**6.26**	6.34
36 to 40 years	6.41	–	–	**6.41**	6.41
41 to 45 years	–	–	–	**–**	6.56
46 to 50 years	6.44	–	–	**6.44**	6.44
51 to 55 years	–	–	–	**–**	–
56 to 60 years	6.62	–	–	**6.62**	6.62
Weighted average	7.88	8.16	6.77	**7.95**	8.05

Note 11
Long-Term Debt
(continued)

The variable-rate portion of Hydro-Québec's debt amounted to 23.2%, or 24.4% after perpetual debt, as at December 31, 2002 (24.6%, or 25.8% after perpetual debt, as at December 31, 2001). For information purposes, a change of 1% in the interest rate would change net income by $97 million ($105 million in 2001), not including the impact of derivative instruments used to manage short-term financial risk (note 14).

Fair value

As at December 31, 2002, the fair value of Hydro-Québec's debt, net of sinking funds and after swaps, amounted to $49,231 million ($47,468 million as at December 31, 2001).

Fair value is obtained by discounting future cash flows, based on term and closing interest rates as at the balance sheet date for similar instruments available on financial markets. Changes in fair value reflect sensitivity to financial market interest rates. However, Management intends to retain these debt securities until maturity. Therefore, as at December 31, 2002, Hydro-Québec did not foresee any significant debt repayments that could result in the realization of this fair value.

Hydro-Québec has undrawn revolving standby credits totaling US$1,500 million and expiring between 2003 and 2006. Any borrowing under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR).

Note 12
Other Long-Term
Liabilities

	note	2002	2001 (restated – note 2)
Accounts payable		**355**	312
Employee future benefit liability	18	**376**	343
Decommissioning of nuclear generating station [a, b]		**157**	100
		888	755

a) The Minister of Natural Resources Canada recently announced the coming into force, on November 15, 2002, of An Act Respecting the Long-Term Management of Nuclear Fuel Waste. The legislation calls for nuclear fuel waste owners in Canada to form a separate legal entity known as the Waste Management Organization (WMO) and to set up a trust with a financial institution in order to finance the implementation of the nuclear fuel waste management proposal that will be adopted by the Government of Canada. In order to satisfy the financial responsibilities incumbent on the nuclear fuel waste owners, the Corporation deposited an initial amount of $20 million in a trust within 10 days of the date the Act came into force. The Corporation will also be required to deposit an additional $4 million per year in the same trust until the Waste Management Organization determines the amount to be paid by each nuclear plant owner. The amount deposited in the trust ($20 million in 2002) is presented as a reduction of the provision for decommissioning of the nuclear generating station.

b) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. In 2001, the Corporation initiated a draft design study, to be completed in 2004, in order to evaluate whether its useful life could be extended by 25 years through refurbishment. If the refurbishment is not carried out, the plant could be decommissioned a few years earlier, depending on technical and economic factors. Pending a decision on the refurbishment project and hence the useful life of the plant, the financial statements continue to reflect a decommissioning in 2013. Once the decision is made, future decommissioning and amortization costs may vary significantly from the amounts reported in these financial statements based on the end-of-life date retained and the increase inherent in the methods used to calculate depreciation and amortization and the costs of decommissioning the plant. As at December 31, 2002, the net book value of Gentilly-2 was $790 million, and the portion for which a provision remained to be made for future decommissioning costs approximated $660 million, based on decommissioning in 2013.

Note 13
Perpetual Debt

Perpetual notes in the amount of US$400 million bear interest at a rate established semiannually based on LIBOR. They are guaranteed by the Québec government and are only redeemable at the Corporation's option. Effective January 1, 2002, these notes are shown on the balance sheet at the closing rate in effect at the balance sheet date, whereas in 2001 they were shown at the rate in effect on the date of issue. For comparative purposes, the book value of these notes has been restated to December 31, 2001, in order to present these amounts at the rate in effect at the balance sheet date.

As at December 31, 2002, their fair value was $540 million ($566 million as at December 31, 2001). As at December 31, 2002 and 2001, the LIBOR for perpetual notes was 1.94% and 3.09%, respectively.

Note 14
Derivative Instruments

Derivative instruments used by Hydro-Québec for hedging purposes are always associated with a reverse risk position.

Hydro-Québec concludes currency swaps in order to manage the foreign exchange risk associated with payments of principal on long-term debt, interest payments and sales in U.S. dollars. Some of these currency swaps allow for interest rate exchanges to change long-term exposure to interest rate risk. Interest rate swaps that do not allow for exchanges of principal are also used to manage this risk.

The valuation of these swaps, with terms through 2022, showed a positive fair value of $407 million (negative fair value of $338 million as at December 31, 2001).

The following table shows the notional amount of these swaps, expressed in Canadian dollars or other currencies.

	2002[a]	2001[a]
CANADIAN DOLLARS	**526**	(389)
U.S. DOLLARS	**(1,991)**	(1,768)
OTHER CURRENCIES		
Yen	**46,500**	57,500
Euros	**727**	880
Pounds sterling	**300**	300
Swiss francs	**97**	97
Unidades de Fomento (indexed Chilean pesos)	**(7)**	(4)

a) Figures in parentheses represent amounts to be paid.

In managing short-term financial risks, Hydro-Québec assesses, on an ongoing basis, the overall impact of variations in exchange rates, interest rates and the prices of commodities. Hydro-Québec holds options and forward contracts designed to hedge several positions. It also uses derivative instruments to manage market risks resulting from fluctuations in energy prices. The fair value of these instruments is presented by specific risk in the following table. These derivative instruments mature through March 2005.

Note 14
Derivative
Instruments
(continued)

The fair value of derivative instruments reflects the amount that Hydro-Québec would receive (*financial assets*) or pay (*financial liabilities*) as at the balance sheet date in terminating these instruments.

	2002	2001
EXCHANGE RISK		
Forward exchange contracts and options		
Financial assets	**22**	38
Financial liabilities	**(7)**	(2)
	15	36
INTEREST RATE RISK		
Forward rate agreements, options and swaps		
Financial assets	**7**	33
Financial liabilities	**(101)**	(89)
	(94)	(56)
RISK OF CHANGE IN ENERGY AND COMMODITY PRICES		
Forward contracts, options and swaps		
Financial assets	**29**	32
Financial liabilities	**(18)**	(60)
	11	(28)
	(68)	(48)

Credit risk

Derivative instruments include an element of risk, since a counterparty might not meet its obligations. However, this risk is moderate as Hydro-Québec deals only with Canadian and international financial institutions with high credit ratings. Credit risk exposure is also reduced by applying a credit policy limiting credit risk concentrations and a customer credit risk evaluation program, as well as by adopting credit limits, where necessary. As at December 31, 2002, Hydro-Québec did not foresee any material loss arising from counterparty default.

Note 15 Interests in Joint Ventures

The share of the principal joint venture items included in the consolidated financial statements is presented in the following table. These joint ventures specifically include the interest in Noverco Inc. and the Corporation's interests in various foreign joint ventures, mainly through Hydro-Québec International.

	2002	2001
OPERATIONS		
Revenue	**933**	1,148
Expenditure and financial expenses	**871**	1,095
Non-controlling interest	**20**	18
Net income	**42**	35
BALANCE SHEET		
Current assets	**192**	186
Long-term assets	**1,925**	1,793
Current liabilities	**213**	216
Long-term liabilities	**1,102**	1,096
Non-controlling interest	**216**	174
Net assets	**586**	493
CASH FLOWS		
Operating activities	**156**	125
Investing activities	**(121)**	(121)
Financing activities	**(5)**	(1)
Net change in cash and cash equivalents	**30**	3

Noverco Inc.

Hydro-Québec holds 41.2% of the outstanding common shares of Noverco Inc. and options on an additional 9.2%. Under the Noverco Inc. shareholders' agreement, the Corporation agreed to mechanisms enabling the joint owners to convert their interests into liquidities under certain conditions.

Noverco Inc., through its interest in Gaz Métropolitain and Company, Limited Partnership (GMCLP), disclosed unrecorded future income taxes of $94 million on regulated activities in 2002 ($98 million in 2001). In the past, the Régie de l'énergie and the National Energy Board have allowed these future income taxes to be included in rates as they become payable.

GMCLP charges pension and other retirement benefits to income as the amounts are disbursed, in accordance with regulatory practice.

Foreign joint ventures

The Corporation holds interests in joint ventures, primarily through HQI. These joint ventures are essentially involved in the operation and construction of transmission systems and hydroelectric generating stations. They mainly operate in South and Central America and Australia.

Note 16
Shareholder's Equity

The authorized share capital comprises 50,000,000 shares with a par value of $100 each, and 43,741,090 shares were issued and paid.

Under the *Hydro-Québec Act*, any dividends to be paid by the Corporation are declared once a year by the Québec government, which also determines the terms and conditions of payment. For a given fiscal year, they cannot exceed the distributable surplus, equal to 75% of the year's operating income and net investment income, less interest on debt securities and amortization of borrowing discounts and expenses. This calculation is made on the basis of the consolidated financial statements.

However, in respect of a given fiscal year, no dividend may be declared in an amount that would have the effect of reducing the rate of capitalization to less than 25% at the end of the year. The government declares the dividends for a given year within 30 days after the Corporation has sent the government the financial data relative to the distributable surplus. On expiry of the time prescribed, any distributable surplus or part thereof that has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

For 2002, the Québec government declared dividends of $763 million, which is less than the maximum permitted.

Dividends declared are deducted from the retained earnings of the year for which they were declared.

Note 17
Change in Non-Cash Working Capital Items

	2002	2001
Accounts receivable	**(136)**	26
Materials, fuel and supplies	**7**	(23)
Accounts payable	**142**	85
Accrued interest	**(44)**	(38)
	(31)	50

Note 18
Employee Future Benefits

The Corporation's pension plan (the "Pension Plan") is a funded plan that ensures pension benefits based on number of years of service and average five best years of earnings. The post-retirement and post-employment benefits offered by the Corporation also include group life, medical and hospitalization, and salary insurance plans. However, most of these plans are not funded, with the exception of the long-term disability salary insurance plan, which is fully funded, and the supplementary group life insurance plan, which is partially funded.

The following table presents information concerning the defined benefit plans, established by independent actuaries:

	2002 Pension Plan	2001 Pension Plan	**2002** Other plans	2001 Other plans
ACCRUED BENEFIT OBLIGATION				
Balance at beginning of year	**7,231**	6,966	**511**	522
Current service cost	**220**	214	**22**	19
Benefit payments and refunds	**(319)**	(321)	**(31)**	(31)
Interest on obligation	**484**	451	**34**	33
Actuarial losses (gains)	**321**	(79)	**28**	(20)
Adjustments arising from plan amendments	**–**	–	**–**	(12)
Balance at end of year	**7,937**	7,231	**564**	511
PLAN ASSETS AT FAIR VALUE				
Balance at beginning of year	**9,149**	9,452	**40**	31
Actual return on plan assets during the year	**(480)**	33	**1**	1
Employee contributions	**6**	13	**–**	–
Hydro-Québec contributions	**–**	–	**12**	13
Benefit payments and refunds	**(319)**	(321)	**(7)**	(5)
Administrative fees	**(30)**	(28)	**–**	–
Balance at end of year	**8,326**	9,149	**46**	40
SURPLUS (DEFICIT) AT END OF YEAR	**389**	1,918	**(518)**	(471)
Unamortized past service costs	**270**	348	**1**	2
Unamortized net loss (gain)	**1,766**	194	**(9)**	(39)
Unamortized transitional obligation (asset)	**(1,673)**	(1,825)	**150**	165
ACCRUED BENEFIT ASSET (LIABILITY)	**752**	635	**(376)**	(343)
SIGNIFICANT ACTUARIAL ASSUMPTIONS (%)				
Discount rate	**6.58**	6.62	**6.58**	6.62
Expected rate of return on plan assets	**7.45**	7.67	**3.00**	4.98
Salary escalation rate[a]	**3.15**	2.95	**–**	–

a) This rate is a weighted average which takes salary increases into account as well as promotion opportunities while in service.

As at December 31, 2002, health-care costs were based on an annual growth rate of 7.9% in 2003. Thereafter, based on the assumption used, this rate gradually decreases until it reaches the ultimate rate of 3.7% in 2013.

Note 18
Employee Future Benefits (continued)

Plan assets include securities issued by the Corporation and certain related companies. These securities are grouped under the following asset classes:

	2002 Pension Plan	2001 Pension Plan	**2002** Other plans	2001 Other plans
Bonds and debentures	**551**	689	**–**	–
Shares	**7**	12	**–**	–
Short-term investments	**27**	–	**40**	35
	585	701	**40**	35
PLAN EXPENSE (CREDIT)				
Current service cost[a]	**197**	185	**22**	19
Administrative fees[b]	**30**	28	**–**	–
Interest on obligation	**484**	451	**34**	32
Expected return on plan assets	**(754)**	(718)	**(1)**	(1)
Amortization of transitional obligation (asset)	**(152)**	(152)	**14**	16
Amortization of net actuarial loss (gain)	**–**	–	**2**	(1)
Amortization of past service costs	**78**	116	**–**	4
EXPENSE (CREDIT) FOR THE YEAR	**(117)**	(90)	**71**	69

a) For the long-term disability salary insurance plan, current service cost corresponds to the cost of new disability cases for the year.

b) Administrative fees chargeable to the Pension Plan are fully billed by the Corporation.

The Corporation and all of its employees have been benefiting from a holiday on pension plan contributions since May 10, 1999.

Note 19
Commitments and Contingent Liabilities

Electricity purchased

On May 12, 1969, the Corporation signed a contract with Churchill Falls (Labrador) Corporation Limited (CF(L)Co) whereby the Corporation undertook to purchase substantially all the energy generated at Churchill Falls generating station, which has a rated capacity of 5,428 MW. Under this agreement, the Corporation could be required to provide additional funding to service the debt of CF(L)Co and to pay its expenses should CF(L)Co be unable to do so. Expiring in 2016, this contract will be automatically renewed for a further 25 years under agreed-upon terms and conditions. On June 18, 1999, the Corporation and CF(L)Co also entered into a contract to guarantee the availability of 682 MW of additional power until 2041 for the November 1 to March 31 winter period.

As at December 31, 2002, the Corporation was committed under 80 contracts to purchase electricity from independent power producers for a potential capacity of about 930 MW. The Corporation expects to purchase approximately 4 TWh of energy annually over the initial term of these contracts, which extend through 2029. The majority of these contracts include renewal clauses.

Guarantees
Hydro-Québec had issued letters of credit or guarantees for an amount of $1,903 million as at December 31, 2002.

Capital expenditures
The Corporation expects to invest approximately $2,600 million in fixed assets in 2003.

Agreement respecting the Eastmain-1 project
Within the scope of the Eastmain-1 project, Hydro-Québec signed various agreements with the Grand Council of the Crees (Eeyou Istchee), the Cree Regional Authority, the Eastmain Band, the Cree Nation of Mistissini, the Nemaska Band and the Waskaganish Band. The amounts paid are based on work completion and are included in the cost of the project in the year they are paid.

Litigation
In the normal course of business, Hydro-Québec is party to claims and legal proceedings. Management is of the opinion that the outcome of these legal actions, which can currently be determined with reasonable certainty, will not have an adverse effect on the consolidated financial position or operating results of Hydro-Québec, given the provision for such expenditures.

Note 20 Segmented Information

Hydro-Québec's operations are divided into five segments based on its organizational structure, which reflects how the Corporation's activities are managed:

Distribution: Hydro-Québec Distribution develops and operates the Corporation's distribution system and is responsible for sales and service to Québec customers.

Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's transmission system in Québec, in addition to managing and operating foreign transmission systems and carrying out development projects. The division also manages Hydro-Québec's telecommunications network.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities in Québec and a number of foreign facilities. It also sells electricity on external markets and engages in energy trading activities. In addition, it participates in the Québec wholesale market by responding to calls for tenders from Hydro-Québec Distribution.

Note 20
Segmented Information (continued)

Construction: Hydro-Québec Équipement and SEBJ provide engineering services and carry out construction projects in Québec and in other parts of the world.

Oil and Gas: Hydro-Québec Pétrole et gaz comprises all activities related to the pipeline transmission of oil, natural gas and liquid natural gas, as well as gas distribution. Activities arising from the Québec Oil and Gas Exploration Plan 2002–2010 are also included in this segment.

Corporate and Other Activities: Corporate and Other Activities includes corporate activities such as financial services, human resources, strategic planning and corporate affairs, as well as the activities of the Shared Services Centre, research and development, capital venturing and the commercialization of Hydro-Québec technologies.

The amounts presented for each segment are based on the financial information used to establish the consolidated financial statements. The accounting policies used to calculate these amounts are as described in note 1.

Intersegment transactions related to electricity sales are recorded based on the supply and transmission rates provided under the *Act respecting the Régie de l'énergie*. The Act sets a supply rate for a maximum annual volume of heritage pool electricity of 165 TWh for Québec markets. This volume was not reached in 2002.

In 2002, the Régie de l'énergie authorized Hydro-Québec TransÉnergie to modify its transmission rates retroactive to January 1, 2001. The new rates applied retroactive to 2001 were recorded in the 2001 fiscal year and affect intersegment revenue and, thus, the net income of the Generation, Transmission and Distribution segments. For fiscal 2001, the new rates increased net income by $58 million for the Transmission segment and $21 million for the Generation segment and decreased this item by $79 million for the Distribution segment.

Other intersegment products and services are valued at full cost.

The following tables contain information related to operations and assets by segment and certain geographical information:

Segments

	Distribution	Transmission	Generation	Construction	Oil and Gas	Corporate and Other Activities	Inter-segment[a]	2002 Total
Revenue								
External customers	8,196	293	3,638	6	849	20	–	**13,002**
Intersegment	36	2,734	4,260	1,111[b]	–	730	(8,871)	–
Depreciation, amortization and decommissioning	446	639	828	3	68	78	–	**2,062**
Financial expenses	499	1,062	1,345	–	85	53	(1)	**3,043**
Net income (loss)	(399)	389	1,556	1	35	(56)	–	**1,526**
Capital expenditures (including intangibles)	525	702	1,033	8	49	139	–	**2,456**
Total assets	9,755	18,259	24,583	251	1,771	975	3,484	**59,078**

	Distribution	Transmission	Generation	Construction	Oil and Gas	Corporate and Other Activities	Inter-segment[a]	2001 Total
Revenue								
External customers	7,934	301	3,218	7	1,066	52	–	12,578
Intersegment	23	2,785	4,075	670[b]	–	730	(8,283)	–
Depreciation, amortization and decommissioning	429	578	671	5	71	91	–	1,845
Financial expenses	573	1,139	1,502	–	95	560	(6)	3,863
Net income (loss)	(533)	494	1,191	(4)	21	(574)	–	595
Capital expenditures (including intangibles)	483	548	664	1	41	73	–	1,810
Total assets	9,545	18,223	24,275	126	1,735	953	3,806	58,663

a) Includes assets related to long-term financing that have not been allocated to the operating segments.

b) Intersegment revenue generated by the Construction segment includes an amount of $963 million ($630 million in 2001) that corresponds to capital expenditures in respect of its client segments.

Geographical information

	2002 Revenue	2002 Fixed assets and goodwill	2001 Revenue	2001 Fixed assets and goodwill
Québec	**9,041**	**47,772**	9,051	47,399
Canada, outside Québec	**362**	**2**	140	2
United States	**3,305**	**401**	3,067	277
Chile	**204**	**1,468**	229	1,585
Other countries	**90**	**353**	91	352
	13,002	**49,996**	12,578	49,615

Consolidated Financial Information

($M)	2002	2001	2000	1999	1998
OPERATIONS					
REVENUE	**13,002**	12,578	11,429	9,608	8,879
EXPENDITURE					
Operations	**2,225**	2,134	2,135	1,912	1,681
Electricity and fuel purchased	**3,536**	3,532	2,408	1,109	899
Depreciation, amortization and decommissioning	**2,062**	1,845	1,896	1,731	1,589
Taxes	**580**	591	525	592	610
	8,403	8,102	6,964	5,344	4,779
OPERATING INCOME	**4,599**	4,476	4,465	4,264	4,100
Financial expenses	**3,043**	3,350	3,369	3,345	3,410
Income before non-controlling interest	**1,556**	1,126	1,096	919	690
Non-controlling interest	**30**	18	18	13	11
REPORTED NET INCOME	**1,526**	1,108	1,078	906	679
Restatement of financial expenses*	**–**	513	205	(317)	461
RESTATED NET INCOME	**1,526**	595	873	1,223	218
SUMMARY OF BALANCE SHEET					
Reported total assets	**59,078**	59,861	59,038	56,808	57,336
Restated total assets*	**–**	58,663	58,881	57,150	56,936
Long-term debt	**36,699**	37,269	34,965	36,016	37,833
Reported shareholder's equity	**14,215**	14,834	14,280	13,741	13,288
Restated shareholder's equity*	**–**	13,539	13,513	13,175	12,409
ANNUAL INVESTMENTS					
Fixed assets (including intangibles)	**2,456**	1,810	1,812	1,642	2,092
Other	**(7)**	68	1,678	456	234
Total investments	**2,449**	1,878	3,490	2,098	2,326
FINANCIAL RATIOS					
Interest coverage[a]	**1.56**	1.43	1.37	1.33	1.25
Reported capitalization (%)[b]	**26.2**	26.8	26.2	26.2	25.0
Restated capitalization (%)[b]*	**–**	25.0	25.1	25.4	23.7**
Self-financing (%)[c]	**71.6**	54.6	48.7	58.9	50.2
Reported return on equity (%)[d]	**11.0**	7.6	7.7	6.7	5.2
Restated return on equity (%)[d]*	**–**	4.4	6.5	9.6	1.8
Reported return on revenue (%)[e]	**11.7**	8.8	9.4	9.4	7.6
Restated return on revenue (%)[e]*	**–**	4.7	7.6	12.7	2.5

* *Financial expenses have been restated as a result of the retroactive application of the new foreign currency translation accounting standard (see note 2 to the consolidated financial statements). Consequently, some of the other financial information has been restated.*

** *The capitalization ratio for 1998 was initially 25.0% in accordance with the accounting principles in effect at the time. The dividend payment in respect of 1998 was made pursuant to the provisions of the Hydro-Québec Act.*

a) *Sum of operating income and net investment income divided by gross interest expense.*

b) *Shareholder's equity divided by the sum of shareholder's equity, long-term debt, perpetual debt, short-term borrowings and current portion of long-term debt, less financial assets related to debt.*

c) *Cash provided from operations less dividends paid, divided by the sum of investments, long-term debt maturities and sinking fund redemptions.*

d) *Net income divided by average shareholder's equity.*

e) *Net income divided by revenue.*

Note: Throughout the Supplementary Information section, certain financial and operating figures for previous years have been reclassified to reflect the presentation of the current year.

Operating Statistics

In millions of kilowatthours	2002	2001	2000	1999	1998
ELECTRICITY SALES					
In Québec					
Residential and farm	**53,231**	50,850	51,666	49,315	47,701
General and institutional	**31,695**	30,360	30,490	29,765	28,815
Industrial	**68,535**	66,343	65,950	63,409	61,773
Other	**5,111**	4,659	4,651	4,500	4,519
	158,572	152,212	152,757	146,989	142,808
Outside Québec					
Long-term sales	**2,701**	4,116	6,844	8,711	8,101
Short-term sales	**51,980**	38,698	30,479	16,012	10,464
	54,681	42,814	37,323	24,723	18,565
Total sales	**213,253**	195,026	190,080	171,712	161,373
($M)					
REVENUE FROM SALES					
In Québec					
Residential and farm	**3,246**	3,131	3,167	3,034	2,906
General and institutional	**2,058**	1,973	2,002	1,963	1,894
Industrial	**2,577**	2,482	2,405	2,236	2,214
Other	**231**	217	220	215	213
	8,112	7,803	7,794	7,448	7,227
Outside Québec					
Long-term sales	**275**	326	377	427	391
Short-term sales	**3,232**	2,794	2,003	624	423
	3,507	3,120	2,380	1,051	814
Total revenue from sales	**11,619**	10,923	10,174	8,499	8,041
At December 31					
NUMBER OF CUSTOMER ACCOUNTS					
In Québec					
Residential and farm	**3,295,544**	3,257,361	3,228,610	3,206,211	3,182,033
General and institutional	**281,696**	280,796	281,107	280,383	280,067
Industrial	**13,509**	13,215	13,081	12,732	12,803
Other	**5,793**	5,919	5,941	5,986	6,066
Outside Québec	**25**	86	86	88	61
Total customer accounts	**3,596,567**	3,557,377	3,528,825	3,505,400	3,481,030
In kilowatthours/customer account					
AVERAGE ANNUAL CONSUMPTION					
In Québec					
Residential and farm	**16,247**	15,680	16,058	15,381	15,050
General and institutional	**112,695**	108,061	108,604	106,157	102,826
Industrial	**5,129,097**	5,045,862	5,109,828	4,980,295	4,787,677
Other	**872,780**	785,666	779,911	751,720	735,514

Operating Statistics

In thousands of kilowatts	2002	2001	2000	1999	1998
INSTALLED CAPACITY[a]					
Hydroelectric[b]	**30,392**	30,386	30,389	30,378	30,346
Thermal[c]	**2,267**	2,266	2,266	2,270	2,269
Wind	**2**	2	–	–	–
TOTAL INSTALLED CAPACITY	**32,661**	32,654	32,655	32,648	32,615
In millions of kilowatthours					
TOTAL REQUIREMENTS[d]	**192,916**	186,645	197,895	187,999	176,236
In thousands of kilowatts					
PEAK POWER REQUIREMENTS IN QUÉBEC[e]	**34,989**	30,080	30,412	31,470	31,995
In kilometres					
LINES (OVERHEAD AND UNDERGROUND)					
Transmission and subtransmission	**32,314**	32,273	32,283	32,227	32,144
Distribution	**106,830**[f]	107,139	106,448	105,898	105,705
	139,144	139,412	138,731	138,125	137,849

a) In addition to the output of its own generating stations, Hydro-Québec has access to most of the generation from Churchill Falls power plant, which has a rated capacity of 5,428 MW, and to all of the output from the 133 turbines (each rated 100 MW) of the Matane and Cap-Chat wind farms. Hydro-Québec also has access to the generation from two power plants in Panama and Costa Rica (rated 300 MW and 10 MW, respectively).

b) The installed capacity shown for the generating stations reflects winter operating conditions for the alternators. The data already reported from 1998 to 2001 have been restated accordingly.

c) Includes Gentilly-2 nuclear generating station (rated 675 MW).

d) Total requirements include kilowatthours delivered within Québec and to neighboring systems.

e) Power requirements at the annual demand peak in Québec for the winter beginning in December, including interruptible power. The 2002–2003 winter peak occurred at 5:30 p.m. on January 22, 2003.

f) The data were revised in 2002 in order to more accurately reflect the kilometres belonging to off-grid systems.

Other Information

(%)	2002	2001	2000	1999	1998
RATE INCREASES					
Average increase at May 1	**–**	–	–	–	1.6
Inflation rate	**2.2**	2.5	2.7	1.7	0.9
NUMBER OF EMPLOYEES[a]					
Permanent at December 31	**18,025**	17,679	17,277	17,277	17,468
Temporary (year's average)	**3,632**	3,545	3,399	3,126	3,379
Women (%)	**28.5**	28.3	28.6	27.9	27.4

a) Excludes employees of subsidiaries and joint ventures.

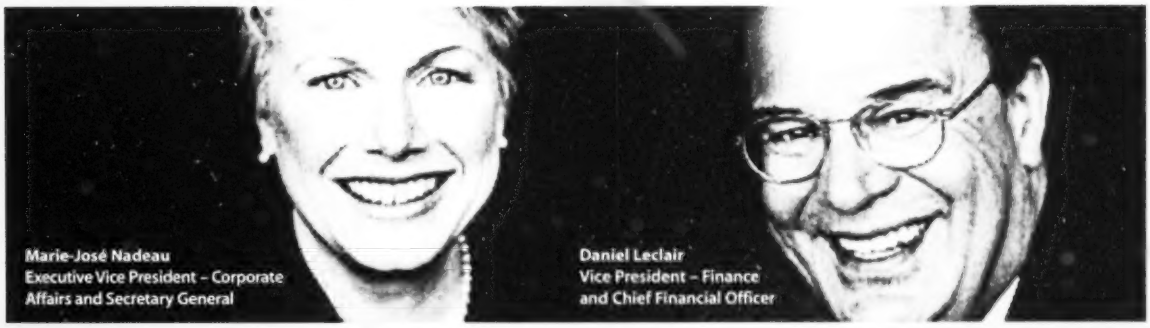
Consolidated Results by Quarter

($M)	1st quarter	2nd quarter	3rd quarter	4th quarter (unaudited)	2002 12-month period (audited)
REVENUE	3,575	2,981	3,353	3,093	**13,002**
EXPENDITURE					
Operations	491	542	554	638	**2,225**
Electricity and fuel purchased	972	777	1,087	700	**3,536**
Depreciation, amortization and decommissioning	465	480	515	602	**2,062**
Taxes	159	173	144	104	**580**
	2,087	1,972	2,300	2,044	**8,403**
OPERATING INCOME	1,488	1,009	1,053	1,049	**4,599**
Financial expenses	790	771	759	723	**3,043**
Income before non-controlling interest	698	238	294	326	**1,556**
Non-controlling interest	8	11	7	4	**30**
NET INCOME	690	227	287	322	**1,526**

($M)	1st quarter	2nd quarter	3rd quarter	4th quarter (unaudited)	2001 12-month period (audited)
REVENUE	3,837	2,909	2,762	3,070	12,578
EXPENDITURE					
Operations	469	545	512	608	2,134
Electricity and fuel purchased	1,055	802	831	844	3,532
Depreciation, amortization and decommissioning	457	486	477	425	1,845
Taxes	156	174	151	110	591
	2,137	2,007	1,971	1,987	8,102
OPERATING INCOME	1,700	902	791	1,083	4,476
Financial expenses	1,140	779	935	1,009	3,863
Income (loss) before non-controlling interest	560	123	(144)	74	613
Non-controlling interest	7	11	2	(2)	18
NET INCOME (LOSS)	553	112	(146)	76	595

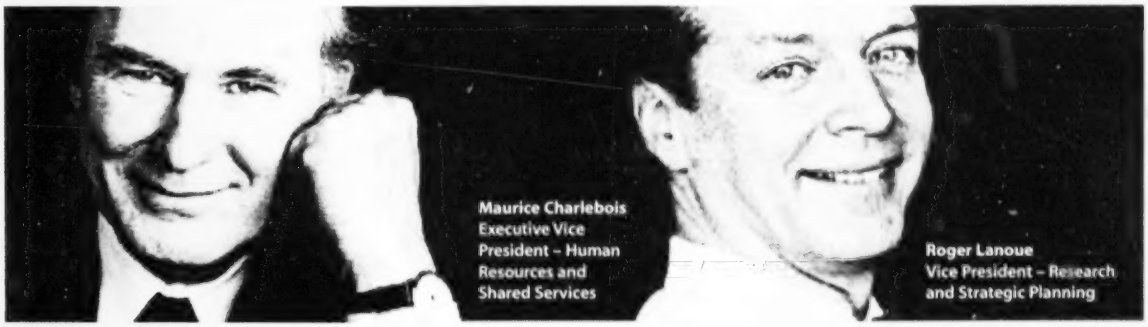
Corporate Management

André Caillé
President and
Chief Executive Officer



Marie-José Nadeau
Executive Vice President – Corporate
Affairs and Secretary General

Daniel Leclair
Vice President – Finance
and Chief Financial Officer



Maurice Charlebois
Executive Vice
President – Human
Resources and
Shared Services

Roger Lanoue
Vice President – Research
and Strategic Planning

Board of Directors

Jacques Laurent

Pierre Bourgie

Michel Boivin

Joseph Benarrosh

Daniel Boulard

Andrée Corriveau

Alain Forand

Bernard Gaudreault

Pierre Grand'Maison

Régis Labeaume

Yvon Lamontagne

André Caillé

Paul Larocque

Sophie Martin

Claude Munger

Michel Noël de Tilly

Serge Racine

Louise Roy

Board Committees

Corporate Governance

Hydro-Québec's Board of Directors is concerned with maintaining the highest possible standards for corporate governance. It therefore fully subscribes to the corporate governance guidelines established by Canadian stock exchanges, even though, legally speaking, it is not required to abide by them because it is not a publicly traded company.

Mission

The Board administers the company's business in accordance with the *Hydro-Québec Act*, the *Companies Act* and the energy policies of the Québec government. Its most important functions involve the analysis and adoption of the Strategic Plan, which describes the company's main orientations, and the annual business plan, which comprises the capital and operating budgets along with the annual performance objectives for members of the management team. Other functions include the monthly review of financial results, the four-month review of management results, the annual evaluation of integrated business risk management, and the selection and evaluation of senior executives. The Board regularly receives and analyzes the subsidiaries' activity reports, financial results and accountability reports.

Independence

A majority of members of the Board come from outside the company. In fact, only one director—the President and Chief Executive Officer—is a member of Senior Management. The Board is responsible for compliance, at all times, with the rules stated in the *Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec* based on the *Regulation respecting the ethics and professional conduct of public office holders*.

Information

Directors are all offered a complete information session on the energy sector and Hydro-Québec's business environment and principal activities. They also receive a director's guide describing the company's specific technical, business and regulatory context, along with the roles and responsibilities of a Board member.

Operation

The Board benefits from the expertise and experience of its members, who work on ten committees: Executive Committee, Distribution, Environment and Social Responsibility, Ethics and Corporate Governance, Finance, Pension Fund Management, Generation, Human Resources, Transmission, and Audit. After every committee meeting, a report by the committee chair is presented at the next Board meeting. The Ethics and Corporate Governance Committee is responsible for assessing the Board's performance and operation. The Executive Committee may exercise the Board's powers, except those reserved by law.

Access to Information and Confidentiality

Hydro-Québec is taking the necessary measures to assure its customers, suppliers and employees of the confidentiality of the personal information it possesses, in accordance with the *Act respecting Access to documents held by public bodies and the Protection of personal information*. In 2002, the company continued implementation of its action plan for the protection of personal information, formulated in 2001. Statements of personal information were updated in cooperation with the units concerned. They were then sent to Québec's access to information commission as required by law. In addition, new managers received training in the protection of personal information. Finally, a new company directive concerning the destruction of personal data contained in outdated computer equipment was adopted in the fall.

During the past year, Hydro-Québec published a guide on access to documents and the protection of personal information. This publication explains the main concepts of the *Act respecting Access to documents held by public bodies and the Protection of personal information* and provides practical advice on how the Act applies to Hydro-Québec. The guide was handed out to all current employees and is given to new employees as well.

Deintegration

The company also published a brochure on deintegration and fair business practices. This document explains how employees must observe the same rules of ethics in conducting company business with internal administrative units affected by market deregulation as they do with external contacts.

Sarbanes-Oxley Act

The Audit Committee of the Board of Directors has asked Management to study the provisions of the *Sarbanes-Oxley Act*, promulgated by American legislators on July 30, 2002. Although Hydro-Québec is not subject to this law, which sets out new governance standards, the company must decide on the best practices to adopt in light of its financial activities in the United States.

Language Guidelines

Efforts to improve the quality of French used at Hydro-Québec continued during the year. A number of proficiency courses were offered to employees in grammar, business correspondence, report writing and other subjects. Nearly 650 people signed up for the 62 sessions that were given. Five terminology bulletins were sent out over the intranet, and some of the definitions contained in the glossary of terms for interconnected systems, an operating standard used at Hydro-Québec TransÉnergie, were revised. Lastly, various promotional and awareness activities were organized internally to highlight the Semaine du français et de la francophonie, a week-long celebration of French language and culture.

In addition, Hydro-Québec's standing committee on language presented the Office de la langue française with its annual report on the company's application of the government policy on the use of French in information technologies.

Report of Activities of the Board of Directors and Board Committees

The Board of Directors is composed of a maximum of 16 members appointed by the Québec government for terms of no more than five years, as well as the President and Chief Executive Officer, who is appointed by the Board with government approval. The Deputy Minister of Natural Resources is an ex officio, non-voting member of the Board.

The Board of Directors met 13 times in 2002, with an attendance rate of about 82%. The Executive Committee held 7 meetings, while the other committees held 57 in all.

The Board authorized the creation of the Human Resources and Shared Services group and reorganized its operating methods and its committees, adding the Generation and Transmission committees. The Board also approved agreements with the James Bay Crees concerning the construction of Eastmain-1 and Eastmain-1-A generating stations and the partial diversion of the Rupert River. The Board authorized the purchase of at least 1,000 MW of wind power over the next 10 years, and allowed the company to begin oil and gas exploration in the Gaspé Peninsula, the Gulf of St. Lawrence and the estuary, with the necessary budget. The Board also authorized a financial risk management framework and regularly monitors trading activities on external markets.

Distribution

The Distribution Committee's role is to advise the Board or the Executive Committee on Hydro-Québec Distribution's activities regarding the procurement of electricity for Québec consumers. In particular, it examines the Electricity Supply Plan, the procedure for tendering and awarding power supply contracts, the *Code of Ethics on Conducting Calls for Tenders*, the calls for tenders and the suppliers chosen.

In 2002, the committee concentrated on the bids selected following the call for tenders for the purchase of 1,200 MW to meet the long-term needs of Québec customers, and on the planned Customer Information System which will significantly change the business practices and procedures of the Sales and Customer Service department.

Environment and Corporate Social Responsibility

The Environment and Corporate Social Responsibility Committee provides advice on environmental management, public health and safety, community relations, social responsibility and corporate image. The committee receives all reports and violation notices related to environmental incidents.

During the year, the committee reviewed environmental studies concerning various hydroelectric projects as well as the report on ISO 14001 implementation at Hydro-Québec Production. It also examined the summary of environmental inspections performed in 2001 and the results of the 2001 environmental inspection program carried out under the public safety section of the policy "Our Environment." In addition, it studied the environmental report for January to June 2002 prepared for the Board of Directors, as well as the 2001 environmental communication plan, and it reviewed the activities carried out in 2001 by the Fondation Hydro-Québec pour l'environnement and the Foundation's projects for 2002. Finally, the committee reviewed the statement of donations and sponsorships and the report on research chairs funded by the company in 2001.

Ethics and Corporate Governance

The Ethics and Corporate Governance Committee ensures that Hydro-Québec is well managed in accordance with the highest standards of ethics and corporate governance and with the relevant laws and regulations. The committee also provides advice on the application and enforcement of the *Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec*. It makes recommendations on rules applicable to the company's business.

In 2002, the committee analyzed accountability reports on the application of corporate policies, particularly the provisions of the policy "Our Corporate Governance" that relate to ethics and to the language of work and communication. The committee examined the application of the rules of ethics and analyzed the actions taken in 2002 regarding the application of the *Charter of the French Language*. It also focused its attention on the policy "Our Acquisition of Goods and Services," which covers four main aspects: security of supply, quality, efficiency of procurement procedures and economic spinoffs.

Finance

The function of the Finance Committee is to advise the Board on financial matters, especially financing, management of corporate funds, insurance, banking, the business plan and ensuing annual budget, financial risk management and integrated business risk management.

This year, the committee focused on risk management. It evaluated the company's main quantifiable risks and the surety bonds paid by Hydro-Québec and its subsidiaries. It also examined the annual accountability report on the application of the policy "Our Assets."

Pension Fund Management

The role of the Pension Fund Management Committee is to advise the Board on investment management and performance, evaluation of portfolio managers and the management of the pension plan, including changes in pension obligations.

This year, the committee recommended that the Board update the management policy for pension fund investments in order to adapt certain terms of application to the current situation. It also reported on the transition from the former reference portfolio to the new one.

In addition, the committee reviewed the performance of the pension plan portfolio and specialized portfolio managers.

Generation

The Generation Committee was established on May 28, 2002, to advise the Board or the Executive Committee on Hydro-Québec Production's activities relating to bids it submits to Hydro-Québec Distribution in response to calls for tenders. It also plays a role in foreign investment and in the activities of the power generation subsidiaries.

During the year, the committee looked specifically at the bid submitted by Hydro-Québec Production in response to the call for tenders issued by Hydro-Québec Distribution to meet domestic electricity needs.

Human Resources

The main role of the Human Resources Committee is to advise the Board on various matters, such as hiring, total compensation, training and succession, including the hiring, appointment, performance review and compensation of the President and Chief Executive Officer and other senior executives.

In 2002, the committee turned its attention to the company's application of the policy "Our Human Resources" and examined the results of the 2001–2006 workforce succession support plan. It also focused on the renewal of the Hydro-Québec specialists' collective agreement as well as the 2003 strategies for negotiations with the company's main unions. The committee analyzed certain aspects of the compensation of the President and Chief Executive Officer, senior executives and employees in terms of the company's performance objectives.

Transmission

The Transmission Committee, set up on November 8, 2002, advises the Board or the Executive Committee on cases to be submitted to the Régie de l'énergie by Hydro-Québec TransÉnergie, as well as on foreign investment and the activities of the transmission subsidiaries.

In 2002, the committee examined the budget for the construction and operation of a merchant transmission line linking Connecticut and Long Island, N.Y. (Cross Sound Cable project), as well as the acquisition of transmission assets belonging to Sistema Interconectado del Norte Grande (SING) by HQI Transelec Chile S.A.

Audit

The main function of the Audit Committee is to assure the Board of Directors that the financial statements accurately present the company's financial position, that internal controls are adequate and effective, and that suitable mechanisms are being applied to identify and manage the major internal and external risks to which the company is exposed. The committee reads the internal audit reports and resulting action plans.

During the year, the committee continued its analysis of the issue of electricity theft. It examined Hydro-Québec Distribution's Customer Information System project and focused particularly on the progress of the project to increase the security of strategic applications. It reviewed the *Sarbanes-Oxley Act*, promulgated in the United States in July 2002, and its effects on Hydro-Québec.

The committee also considered several action plans, including those related to the compliance and automation program for the Island of Montréal underground grid, preventive maintenance on the distribution system, financial risk management and the destruction of personal information contained in outdated computer equipment.

Part I
Interpretation and application

1. In this Code, unless the context indicates otherwise:

a_ **"Act"** means the Hydro-Québec Act, R.S.Q. c. H-5, as amended from time to time;

b_ **"affiliated enterprise"** means a legal person or company in which the Corporation owns, directly or indirectly, securities including shares, conferring more than 10% of voting rights or economic interest;

c_ **"Board"** means the Board of Directors of the Corporation;

d_ **"Committee"** or "Ethics and Corporate Governance Committee" means the Ethics and Corporate Governance Committee established by resolution of the Board of October 17, 1997 (HA-173/97), a copy of which is attached as Schedule D;

e_ **"contract"** includes a proposed contract;

f_ **"control"** means the direct or indirect ownership of securities, including shares, conferring more than 50% of voting rights or economic interest without this right depending on the occurrence of a particular event or allowing the election of the majority of directors;

g_ **"Corporation"** means Hydro-Québec;

h_ **"director"** means, with respect to the Corporation, a member of the Board of Directors of the Corporation, whether or not working full-time within the Corporation;

i_ **"enterprise"** means any form that can be taken by the organization for the production of goods or services or any other business of a commercial, industrial or financial nature or any group seeking to promote certain values, interests or opinions or to exercise an influence on public officials; however this does not include the Corporation or a non-profit association or group that has no financial link with the Corporation or is not incompatible with the objects of the Corporation;

j_ **"executive"** with respect to the Corporation means any contractual manager whose employment conditions are subject to the approval of the Board;

k_ **"immediate family"** means spouse and dependent children;

l_ **"spouse"** includes marriage partners and persons living as if married for more than one year;

m_ **"subsidiary"** means a legal person or corporation controlled directly or indirectly by the Corporation.

2. In this Code, the prohibition to perform an act also applies to any attempt to perform it and any participation in it or incitement to perform it.

2.1 This Code applies to the directors and to the President and Chief Executive Officer and the other executives of the Corporation.

The directors and the President and Chief Executive Officer are also subject to the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 as amended).

Part II
Ethical principles and general rules of professional conduct

3. The director or executive is appointed to contribute to the achievement of the mission of the Corporation in the best interest of Québec. Accordingly, he is expected to use his knowledge, abilities and experience in a way that will promote the effective, fair and efficient accomplishment of the objectives assigned to the Corporation by the Act and the good administration of the property it owns as mandatary of the State.

His contribution shall be made in compliance with the law and with honesty, loyalty, prudence, diligence, efficiency, application and fairness.

3.1 The director or executive respects the following principles in the performance of his duties:

a vision of the Corporation that seeks to make it a world leader in the energy industry by developing its expertise for the benefit of its customers, employees and shareholder and by working with partners in business ventures;

the values underlying the activities of the Corporation as a government-owned business corporation, which include customer satisfaction, an understanding of business, respect for employees, quality improvement, respect for the environment, partnership with local communities and protection of the future;

the principles set out in the basic policies of the Corporation, expressing commitments and conveying a business culture with regard to customers, human resources, acquisition of assets and services, business partners, finance, assets, the environment, social role and corporate governance.

3.2 The director or executive is required, in the performance of his duties, to respect the ethical principles and rules of professional conduct provided in the Act, the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 as amended) as appropriate, and those defined in this Code. In case of discrepancy, the more demanding rules and principles apply.

In case of doubt, act according to the spirit of these principles and rules.

A director or executive who, at the request of the Corporation, serves as director or member of an undertaking or company, is held to the same standards.

4. The director or executive shall not merge the assets of the Corporation with his own; he may not use the assets of the Corporation or information he obtains as a result of his duties for his own profit or the profit of others. These obligations continue even after the director or executive has ceased to hold his position.

5. The director or executive shall seek, in the performance of his duties, only the interest of the Corporation to the exclusion of his own interest or that of others.

5.1 The director or executive is bound to discretion in regard to anything that comes to his knowledge in or during the performance of his duties and is at all times bound to maintain the confidentiality of such information.

5.2 In the performance of his duties, the director or executive shall make decisions without regard for any partisan political considerations.

The Chairman of the Board, the director working full-time within the Corporation and the executive shall demonstrate reserve in the public expression of their political opinions.

6. The director or executive may not directly or indirectly grant, solicit or accept a favor or an undue advantage for himself or for a third party.

In particular, he may not accept or solicit an advantage from a person or undertaking doing business with the Corporation or a subsidiary or acting in the name of or on behalf of such a person or undertaking if this advantage is intended or likely to influence him in the performance of his duties or generate expectations of this nature.

6.1 The director or executive shall, in making decisions, avoid allowing himself to be influenced by offers of employment.

6.2 The director or executive may not accept any gift or hospitality except what is customary and modest in value.

Any other gift or hospitality shall be returned to the giver.

7. The director may not make a commitment to a third party or grant them any guarantee relative to a vote he may be asked to make or any decision whatsoever that the Board may be asked to make.

7.1 The director or executive may not, in the performance of his duties, deal with a person who has ceased to be a director or executive of the Corporation for less than one year if this person is acting on behalf of a third party with respect to a proceeding, negotiation or other transaction to which the Corporation is a party and about which he has information not available to the public.

7.2 After ceasing his duties, no director or executive may disclose confidential information he has obtained or give anyone advice based on information not available to the public concerning the Corporation or any other undertaking or company with which he had direct and substantial dealings during the year preceding the date on which he ceased his duties.

In the year following that date, he may not act on behalf or on account of another party with respect to a procedure, negotiation or other transaction to which the Corporation is a party and about which he has information not available to the public.

8. The director or executive shall collaborate with the Chairman of the Board or the Ethics and Corporate Governance Committee on an issue of ethics or professional conduct when asked to do so.

8.1 A director or executive who intends to be a candidate for elected office shall inform the Chairman of the Board of this intention.

The Chairman of the Board or President and Chief Executive Officer with the same intention shall inform the Secretary General of the Executive Committee.

Part III
Duties and obligations of directors and executives with respect to conflicts of interest

Prevention of conflicts of interest

9. The director or executive shall avoid placing himself in a situation in which his personal interest is in conflict with the duties of his position or in which reasonable doubt is cast on his ability to perform these duties with undivided loyalty.

A director who is employed full-time within the Corporation or one of its subsidiaries shall also avoid performing duties or being bound by commitments that prevent him from devoting the time and attention that the normal exercise of his duties requires.

As for other directors, they shall be sure to devote the time and attention reasonably required in the circumstances for the execution of their duties.

10. No director holding a full-time office with the Corporation, under pain of forfeiture of office, may have any direct or indirect interest in an undertaking, company or association that puts his personal interest in conflict with that of the Corporation.

However, such forfeiture is not incurred if that interest devolves to him by succession or gift, provided that he renounces or disposes of it with all possible dispatch. Meanwhile, sections 12, 13, 15 and 18 apply to this director.

Every other director who has an interest in an undertaking shall, on pain of forfeiture of his office, comply with the provisions of sections 12, 13, 15 and 18.

11. A director or executive of the Corporation who serves as director or executive of an affiliated enterprise shall be specifically authorized by the shareholder or shareholders who control the enterprise concerned to:

a. hold shares, rights or any other security issued by such enterprise and conferring voting rights or economic interest in it or the right to subscribe or buy such shares, rights or securities;

b. benefit from any profit-sharing program, unless he works full-time for the enterprise and the profit-sharing program is closely linked with the individual performance of the director or executive within the affiliated enterprise;

c. benefit from a pension plan granted by the affiliated enterprise if he does not hold a full-time position within the enterprise; or

d. benefit from any advantage granted in advance in the case of a change of control of the affiliated enterprise.

12. A director or executive who:

a. is party to a contract with the Corporation or a subsidiary; or

b. has a direct or indirect interest in an enterprise that is a party to a contract with the Corporation or a subsidiary or is a director, executive or employee of this enterprise;

shall disclose the nature and extent of his interest in writing to the Chairman of the Board.

The same applies to a director who has a direct or indirect interest in any issue being considered by the Board of Directors.

The director shall at all times abstain from conveying information of any kind to any employee, executive or director of the Corporation with respect to this contract or interest.

The director shall abstain from deliberating or voting on any question linked to this interest and avoid trying to influence the related decision. The director shall also withdraw from the meeting for the duration of deliberations and voting on this question.

13. The disclosure required by section 12 occurs, in the case of a director, during the first meeting:

a. in the course of which the contract or question concerned is under study;

b. following the time at which the director who had had no interest in the contract or question concerned acquires such interest;

c. following the time at which the director acquires an interest in the already concluded contract; or

d. following the time at which any person with an interest in a contract or a question under study becomes a director.

14. An executive who is not a director shall make the disclosure required in section 12 immediately after:

a. having learned that the contract or question concerned was or will be studied at a meeting;

b. having acquired the interest, if it is acquired after the contract was concluded or the decision made;

c_ having become an executive, if he becomes one after acquiring the interest.

The executive may not try to influence the directors' decision in any way.

15. The director or executive shall make the disclosure required in section 12 as soon as he has knowledge of a contract contemplated by this section which, as part of the normal business of the Corporation, does not require the approval of the directors.

16. Sections 12 to 15 apply also when the interest concerned is held by a member of the immediate family of the director or executive.

17. The director or executive shall notify the Chairman of the Board in writing of the rights he may invoke against the Corporation, by indicating their nature and their value, as soon as these rights come into existence or when he acquires knowledge of them.

18. The director or executive shall submit to the Chairman of the Board, within 60 days of being appointed and on January 31 of each year in which he remains in office, an attestation in the form provided in Schedule A and containing the following information:

a_ the name of any enterprise in which the director or executive owns, directly or indirectly, securities or assets, including common shares, specifying the nature and quantity in number and proportion of securities owned and value of assets;

b_ the name of any enterprise for which he performs functions or in which he has an interest in the form of a debt, right, priority, mortgage or significant commercial or financial benefit; and

c_ to the best of his knowledge, the information specified in the preceding paragraphs concerning his employer and the corporation, company or enterprise of which he is owner, shareholder, director or executive.

A director or executive to whom the provisions of paragraphs a) to c) do not apply shall fill out an attestation to that effect and present it to the Chairman of the Board.

The director or executive shall also produce such an attestation within 60 days of the occurrence of a significant change in its content.

The attestations presented pursuant to this section are treated as confidential.

19. The Chairman of the Board submits the attestations received pursuant to sections 12 to 18 to the Secretary of the Corporation, who keeps them at the disposal of the members of the Board and the Ethics and Corporate Governance Committee.

Moreover, the Secretary of the Corporation notifies the Ethics and Corporate Governance Committee of any failure to satisfy the obligations provided for in sections 12 to 18 as soon as the Secretary becomes aware of them.

Waivers

20. This Code does not apply:

a_ to owning securities when the size of the holding probably does not place the director or executive in a conflict of interest;

b_ to owning an interest by way of a mutual fund in whose management the director or executive plays no role directly or indirectly;

c_ to owning interests through a blind trust whose beneficiary cannot know its make-up;

d_ to owning a minimum number of shares required to be eligible as director of a corporation;

e_ to an interest which, by its nature and extent, is common to the public at large or a particular sector in which the director or executive operates;

f_ to a directors' liability insurance agreement; or

g_ to the owning of shares issued or guaranteed by the Corporation, a government or municipality under the same conditions for everyone.

Attestation

20.1 Within sixty days of the adoption of this Code by the Board, each director shall submit to the Chairman of the Board and the Secretary of the Corporation the attestation appearing in Schedule B.

Each new director shall do the same within sixty days of his appointment to this position.

Part IV

Remuneration

20.2 The director or executive, for the exercise of his duties, is entitled solely to the remuneration related to those duties. Such remuneration may not include, even partially, monetary advantages such as those established, in particular, by a profit-sharing plan based on the variation in the value of shares or on a stake in the capital stock of the Corporation.

20.3 A director or executive dismissed for just and sufficient cause may not receive a severance allowance or payment.

20.4 A director or executive who quits his duties, who has received or is receiving a severance allowance or payment and who holds an office, employment or any other remunerated position in the public sector during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives is lower than that he received previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.5 Anyone who has received or is receiving a severance allowance or payment from the public sector and receives a salary as director or executive during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives as director or executive is lower than that he was receiving previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.6 A President and Chief Executive Officer who has ceased to perform his duties, who has received so-called assisted departure measures and who, within two years after his departure, accepts an office, employment or any other remunerated position in the public sector shall refund the sum corresponding to the value of the measures received by him, up to the amount of the remuneration received, by the fact of his return to the public sector, during that two-year period.

20.7 Part-time teaching by a director or executive is not covered by subsections 20.2 to 20.6.

20.8 For the application of subsections 20.2 to 20.6, "public sector" means the bodies, institutions and corporations referred to in Schedule C.

The period covered by the severance allowance or payment referred to in subsections 20.4 and 20.5 shall correspond to the period that would have been covered by the same amount if the person had received it as a salary in his former office, employment or position.

Part V
Application of the Code

Competent authorities

20.9 The Associate Secretary General for Senior Positions of the Ministère du Conseil Exécutif is the competent authority for the application of this Code with respect to the Chairman of the Board and the other directors of the Corporation appointed by the Government.

The Chairman of the Board is the competent authority with respect to other directors or executives of the Corporation.

The Chairman of the Board shall ensure observance of the ethical principles and rules of professional conduct by the directors and the executives of the Corporation.

21. The Ethics and Corporate Governance Committee has as its mission to advise the competent authority with respect to ethics and professional conduct.

The Committee also performs the duties invested in it by the resolution appearing in Schedule D and performs any other duties related to ethics entrusted to it by the Board.

In the performance of its duties, the Ethics and Corporate Governance Committee may become acquainted with the attestations contemplated by section 19.

22. When a director or executive is accused of a violation of ethics or the rules of professional conduct, the Committee is responsible for collecting all relevant information. It makes a report of its findings to the competent authority and recommends appropriate measures, if any.

The competent authority notifies the director or executive of the alleged violations and the possible penalties. It informs him that he has seven days in which to respond and if he requests, to be heard on this matter.

23. The Committee may render advisory opinions on the provisions of this Code and their application to specific cases, even hypothetical ones. It is not required to limit its views to the terms contained in the request.

23.1 In order to allow an appropriate decision to be made in the case of an urgent situation requiring fast response or in an alleged case of serious misconduct, the competent authority may temporarily relieve of his duties, with remuneration, the director or executive who is accused of violations of ethics or the rules of professional conduct.

24. The Secretary of the Corporation keeps records in which are stored the statements, disclosures and attestations that must be submitted to it under this Code, the reports, decisions and advisory opinions of the Committee and the decisions of the competent authority with respect to ethics and professional conduct.

The Secretary shall also take the necessary steps to ensure the confidentiality of the information provided by the directors and executives pursuant to this Code.

25. The Committee may consult and receive opinions from outside counsel or experts on any issue it considers appropriate.

26. A director or executive does not violate the provisions of this Code if he has obtained in advance a favorable decision from the Committee, on the following conditions:

a. the decision was obtained before the facts on which it was based became a reality;

b. the decision was submitted to the Board;

c. all of the relevant facts were fully disclosed to the Committee exactly and completely; and

d. the director or executive has complied with all the requirements of the decision.

27. The Committee and the competent authority preserve the anonymity of complainants, applicants and informers unless there is a clear intention to do otherwise. They may not be forced to reveal information likely to disclose their identity except if the law or a court so requires.

Penalties

28. Upon concluding that a provision of the law, the *Regulation respecting the ethics and professional conduct of public office holders* or this Code has been violated, the competent authority may impose either of the following penalties:

a. for an executive, the appropriate penalty, which can extend as far as termination of employment; and

b. for a director, reprimand, suspension without remuneration for a maximum of three months, or removal from the Board.

However, when the competent authority is the Associate Secretary General contemplated by section 20.9, the penalty is imposed by the Secretary General of the Executive Committee. If the penalty proposed consists of the removal of a public office holder appointed or designated by the Government, it can only be imposed by the latter; in this case, the Secretary General of the Executive Committee may immediately suspend the public office holder without remuneration for a period not exceeding 30 days.

Any penalty imposed on a director and the decision to temporarily relieve him of his duties must be in writing and give the reasons therefor.

29. In the case of a violation of section 10, the competent authority records in writing the forfeiture of office of the violator.

30. The director or executive shall render an account and restore to the Corporation any profits earned or benefits received as a result of or on the occasion of a violation of the provisions of this Code.

31. A director's vote shall not be a casting vote if it is made in violation of the provisions of this Code or associated with such a violation, or if the director fails to produce the attestation contemplated by section 18.

The schedules may be consulted on Hydro-Québec's website (www.hydroquebec.com)

Hydroelectric generating stations	Robert-Bourassa	5,616,000	Brisay	469,300	Rapides-des-Quinze	94,560
	La Grande-4	2,778,750	Laforge-2	319,200	Chute-des-Chats	89,300
	La Grande-3	2,418,059	Trenche	302,400	Bryson	61,000
	La Grande-2-A	2,106,000	Beaumont	243,000	Hart-Jaune	50,490
	Beauharnois	1,652,380	La Tuque	219,600	Rivière-des-Prairies	48,300
	Manic-5	1,527,600	Shawinigan-2	202,601	Rapide-2	48,000
	La Grande-1	1,436,400	Paugan	201,975	Rapide-7	48,000
	Manic-3	1,244,400	Rapide-Blanc	201,600	Chute-Hemmings	28,800
	Bersimis-1	1,124,803	Manic-1	184,410	Hull-2	27,280
	Manic-5-PA	1,064,000	Shawinigan-3	183,600	Sept-Chutes	21,600
	Manic-2	1,023,930	Chelsea	150,700	Lac-Robertson	21,000
	Laforge-1	877,800	Grand-Mère[a]	149,575	Drummondville	16,200
	Bersimis-2	844,550	Rapides-des-Îles	146,520	Saint-Narcisse	15,000
	Outardes-3	756,200	La Gabelle	136,580	Chute-Bell	9,900
	Carillon	752,080	Les Cèdres	135,000	Mitis-1	6,400
	Outardes-4	630,400	Première-Chute	130,320	Mitis-2	4,250
	Outardes-2	471,750	Rapides-Farmers	98,250	Chute-Burroughs	1,600
Thermal generating stations	**Nuclear**		La Romaine	4,935	Kangiqsujuaq	1,520
	Gentilly-2	675,000	Obedjiwan	4,900	Kangirsuk	1,360
	Oil		Blanc-Sablon[b]	4,800	L'Île-d'Entrée	1,190
	Tracy	600,000	Kuujjuaq	4,335	Quaqtaq	1,085
	Gas-turbine		Kuujjuarapik	3,405	Ivujivik	1,015
	Bécancour	428,200	Inukjuak	2,990	Umiujaq	1,050
	La Citière	280,000	Povungnituk	2,870	Akulivik	900
	Cadillac	162,000	Port-Menier	2,790	Tasiujaq	850
	Diesel		Weymontachie	2,220	Aupaluk	780
	Îles-de-la-Madeleine	67,200	Salluit	2,000	Clova	530
	La Tabatière[b]	6,700	Kangiqsualujjuaq	1,920	Saint-Augustin[b]	400
Wind farm	Saint-Ulric	2,250				

Total installed capacity at December 31, 2002[c]	Hydroelectric generating stations[d] (51)	30,391,412
	Thermal generating stations (29)	2,266,945
	Wind farm (1)	2,250
	Total	**32,660,607**

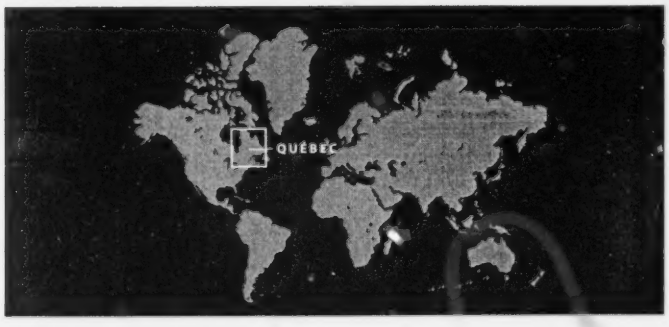
Hydroelectric generating stations under construction (Capacity in kW)	Sainte-Marguerite-3	882,000
	Toulnustouc	553,000
	Eastmain-1	480,000
	Grand-Mère[a]	220,000
	Mercier	60,000

a) Grand-Mère generating station will cease its operations when the new Grand-Mère generating station is commissioned. The new facility is being built next to the old one.

b) Kept in reserve since the commissioning of Lac-Robertson generating station.

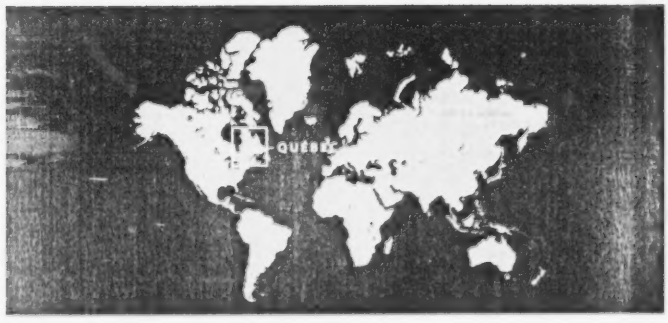
c) In addition to the installed capacity of its own generating facilities, Hydro-Québec has access to most of the output from Churchill Falls power plant, which has a rated capacity of 5,428 MW, and to all the output from 133 turbines (each rated 100 MW) at Matane and Cap-Chat wind farms. Hydro-Québec also operates two generating stations in Panama and Costa Rica, rated 300 MW and 10 MW respectively.

d) The installed capacity of the generating stations is equivalent to that of generating units operating in winter conditions.



97%

of Hydro-Québec's electricity output comes from water power, which contributes to reducing greenhouse gas emissions.



97%

of Hydro-Québec's electricity output comes from water power, which contributes to reducing greenhouse gas emissions.

Hydro-Québec
75 René-Lévesque Blvd. West
Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-2211

Hydro-Québec International (HQI) is responsible for investment and the sale of professional services outside Canada and the U.S. Since HQI has entrusted Hydro-Québec with the management of its operations, each Hydro-Québec business unit is responsible for foreign operations in its spheres of competence.

75 René-Lévesque Blvd. West
20th floor
Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-4020

Hydro-Québec CapiTech is a corporate venture capital company that invests in companies selling energy-related technologies and services.

75 René-Lévesque Blvd. West
22nd floor
Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-4783

Société d'énergie de la Baie James chiefly provides world-class services in engineering and in carrying out construction projects in the energy industry, both in Québec and internationally.

888 de Maisonneuve Blvd. East
6th floor
Montréal, Québec H2L 5B2
CANADA
Telephone: (514) 286-2020

HQ Energy Marketing conducts energy transactions including sales, purchases and exchanges in Canada as well as in the U.S. through H.Q. Energy Services (U.S.).

75 René-Lévesque Blvd. West
18th floor
Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-4304

Noverco, a holding company in which Hydro-Québec has a stake, controls a large number of companies involved primarily in the transmission and distribution of natural gas.

75 René-Lévesque Blvd. West
8th floor
Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-7830

The following publications can be downloaded from our website (**www.hydroquebec.com**) or ordered at **1 800 363-7443**:

Strategic Plan 2002–2006
Annual Report 2002
(this document)
Sustainability Report 2002
Financial Profile 2002–2003

Units of Measure

$M	millions of dollars
$B	billions of dollars
kW	kilowatt (one thousand watts)
MW	megawatt (one million watts)
GW	gigawatt (one million kilowatts)
GWh	gigawatthour (one million kilowatthours)
TWh	terawatthour (one billion kilowatthours)

This document can be recycled.
With the exception of the cover, it is printed on Québec-produced recycled paper containing 20% de-inked fibres.

© Hydro-Québec
Affaires corporatives et secrétariat général
Reproduction authorized with reference to source
Legal deposit: 1st quarter 2003
National Library of Canada
Bibliothèque nationale du Québec
ISBN 2-550-40534-X
ISSN 0702-6706
2002G200A

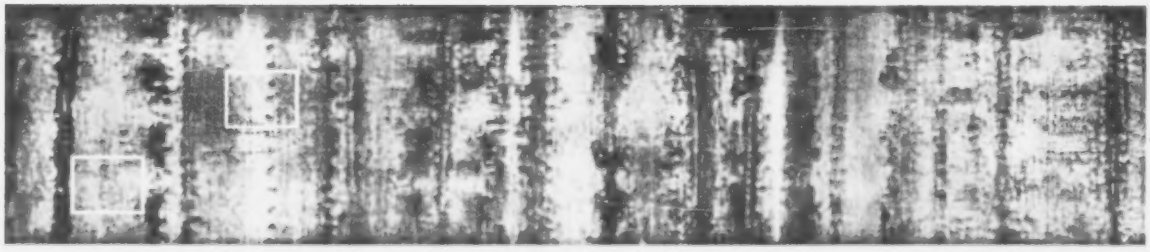
Ce document est également publié en français.

Hydro-Québec wishes to thank all the employees whose photos appear in this Annual Report.

JEAN-PAUL MOUSSEAU
1947–1991

This monumental fibreglass and resin mural (measuring 4.6 m by 22.9 m and weighing 1,360 kg) has hung over the elevators in the lobby of Hydro-Québec's head office building since 1962. It is illuminated by 1,280 m of neon and argon tubes in eight different colors. The play of light allows nearly infinite variations. In the mid-1980s, the lighting system failed. Hydro-Québec decided to restore it in 2002 for the 40th anniversary of the work's creation. This relighting is in keeping with the artist's original concept, in which the electricity creates perpetual changes in light and color. Jean-Paul Mousseau's mural was one of the first Québec examples of art integrated with architecture. For the artist, it was essential that art be accessible to everyone. Hydro-Québec is proud to participate in the preservation of Québec's cultural heritage.

Details shown on the covers



Lumière et mouvement dans la couleur, 1962, mural by Jean-Paul Mousseau